SUPREME COURT, U. S. No. 996

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1967

BENJAMIN (BENN) MYZEL, *et al.*,
Petitioners,

v.

HARRY FIELDS,
Respondent.

BENJAMIN (BENN) MYZEL, *et al.*,
Petitioners,

v.

SAMUEL H. KING,
Respondent.

BENJAMIN (BENN) MYZEL, *et al.*,
Petitioners,

v.

RITA VERTELNEY, Special Administratrix, etc.,
Respondent.

BENJAMIN (BENN) MYZEL, *et al.*,
Petitioners,

v.

GORDON M. COHEN,
Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

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PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

Benjamin Myzel, Philip Myzel, Zelman Levine, Clarence S. Levine, Orrin J. Levine, William P. Levine and Lakeside Industries, Inc., hereby petition for a writ of certiorari to review the judgments of the United States Court of Appeals for the Eighth Circuit entered on October 12, 1967, which affirmed the judgments of the District Court entered on November 22, 1965.

Opinions Below

The opinion of the Court of Appeals (App. A, pp. A1-A53, *infra*) is reported at F.2d . The opinions of the District Court are not reported and are included in Appendix A at pp. A54-A79.

Jurisdiction

The judgments of the Court of Appeals were entered on October 12, 1967 (App. B, pp. A80-A83, *infra*). Respondents' petition for rehearing was denied by order dated November 7, 1967. The jurisdiction of this court is invoked under 28 U.S.C. § 1254(1).

Questions Presented

A. Whether a plaintiff must prove scienter, *i.e.* knowledge of the falsity of the representation, as a necessary element in a private action under Rule 10b-5.

B. Whether damages recoverable in a private action under Rule 10b-5 can exceed those determined under the tort "out-of-pocket" measure of damages.

C. Whether laches is an available defense in a private action under Rule 10b-5.

D. Whether an intrastate telephone call can supply the basis for jurisdiction under Section 10(b) and Rule 10b-5.

E. Whether a corporation can be liable in a private action under Rule 10b-5 for violations of that rule committed by officers and shareholders of its predecessor.

F. Whether a grossly negligent director-insider of a corporation, on notice as to all relevant facts concerning the corporation, can recover damages in a private action under Rule 10b-5 arising from the sale by him of the corporation's stock.

Statutes Involved

The relevant provisions of the Securities Exchange Act of 1934, 48 Stat. 881, 15 U.S.C. 78a, *et seq.*, and the Securities Act of 1933, 48 Stat. 74, 15 U.S.C. 77a, *et seq.*, are set forth in Appendix C, *infra*, pp. A58-A59, together with the text of Rule 10b-5 of the Securities and Exchange Commission, 17 C.F.R. 240.10b-5.

Statement*

These four actions were brought and raise important questions of law under Section 10(b) of the Securities Exchange Act of 1934 and Rule 10(b) thereunder. Jurisdiction of the district court was based upon Section 27 of the Securities Exchange Act of 1934 (48 Stat. 902, 15 U.S.C. §78aa). Respondents are Harry Fields, Samuel H. King, Joseph S. Vertelney** and Gordon M. Cohen. Petitioners are Benjamin Myzel, Philip Myzel, Zelman Levine, Clarence S. Levine, Orrin J. Levine, William P. Levine and Lakeside Industries, Inc. In essence, the actions are based on a claim that respondents were induced to sell shares of stock in Lakeside Plastics and Engraving Co., a small, closely-held local corporation, to petitioners because of misrepresentations or omissions to state material facts (R. 3-5, 18-19, 23-24, 27-29). The stock had been bought seven

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* Figures in parentheses preceded by the legend "R." refer to pages of Volume I and Volume II of the printed Record; figures in parentheses preceded by the legend "III R." refer to the pages of Volume III of the printed Record containing various exhibits; the legend "P. Exh." refers to Plaintiffs' (Respondents') Exhibits, the legend "D.M. Exh." refers to Defendants (Petitioners) Myzels' Exhibits; and the legend "D. L. Exh." refers to Defendants (Petitioners) Levines' Exhibits.

** Respondent Vertelney died before these actions were tried, and his widow, Rita Vertelney, was substituted in his place as special administratrix (R. 39-40, 68-70). For convenience, reference is made to "Respondent Vertelney" as if he were still alive.

years before for $10,000, and was sold for approximately $6,400 (R. 79-80, 105-06, 150, 316-17, 335-38). The actions were brought nine years later, after a number of corporate changes and developments. The jury found for respondents and awarded damages of $411,000 (R. 804-7), apparently based on an evaluation of the corporation's worth some years after the sales which gave rise to the actions.

Lakeside Plastics and Engraving Co. (LPE) was a Minnesota company organized in 1946 (D.M. Exh. B., III R. 1). Two of the petitioners, Clarence and Zelman Levine, were shareholders, officers and directors of LPE (R. 502; D.M. Exh. A., III R. 2). Respondents were among the original subscribers of common stock at a price of $50 per share and received the following number of shares: Harry Fields (30 shares), Joseph S. Vertelney (100 shares), Samuel H. King (30 shares) and Gordon M. Cohen (40 shares) (D.M. Exh. B., III R. 2-3).

In 1948, Lakeside Plastics Sales Co. ("LPS") was organized in Illinois by two other petitioners, Orrin and William Levine (P. Exh. B., III R. 4). LPS was the sales agency for LPE products (R. 388-391). LPS stock was equally held by Orrin and William Levine (R. 380; P. Exh. 5-A, III R. 4). They were also shareholders and at various times directors of LPE (R. 387, 411, 475-76, 479; D.M. Exh. A., III R. 2).

In its early years, LPE made little financial progress. At the 1949 annual meeting respondent Fields proposed the liquidation of LPE (R. 333-34). Each of the respondents were disappointed with LPE's lack of progress (R. 96, 173, 351-52). In 1952 LPE earned a profit of $7,500 on gross sales of $249,000, but the company still had an earned surplus deficit of approximately $43,000 (P. Exh. 3-D(4), 6, III R. 40-41).

In March, 1953 LPE repaid all accumulated bank indebtedness, and the bank returned LPE stock pledged by the stockholders (R. 175-76, 263). For the first four months of 1953, LPE showed sales of $256,000 and a net profit of approximately $30,000 (R. 556-56; P. Exh. 3-D(5), III R. 48). By year end, however, its profit was only $20,000, and the earned surplus deficit amounted to $23,000 (P. Exh. 3-D(6), III R. 52-53).

In late 1953 and early 1954, respondents sold their LPE stock to either Benjamin or Philip Myzel, the latter acting on behalf of his brother, for approximately $6,400 (R. 79-80, 105-06, 150, 316-17, 335-38). The Myzels paid cash (R. 660-61), the stock certificates were personally delivered (R. 84, 318, 339, 580), and all telephone calls in connection with the transaction were wholly to persons within the same state (R. 79-81, 148-50, 314, 318, 335; A 2).* In 1954, Benjamin Myzel sold some of these shares to LPS for approximately $11,000 (R. 451-57; D.M. Exh. A, III R. 5-6, 9).

Respondents testified that the Myzels had stated that the company was in "bad shape" and on the "verge of bankruptcy," and that Benjamin Myzel had sold or was selling his LPE stock (R. 79, 149, 315, 337). Respondents also testified to their lack of awareness that Philip Myzel was purchasing stock for Benjamin Myzel, and claimed that both Myzels acted for the Levines (R. 3, 18, 24, 28, 587, 592, 626). Respondents indicated they were not told of LPE's increased sales and profits in 1953 (R. 4, 18, 23, 27, 133). Respondents base their claim on these and similar misrepresentations and omissions.

Petitioners' testimony contradicted that of respondents. The Myzels denied making the alleged misrepresentations

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* The figures in parentheses preceded by the letter "A" refer to the opinion of the Court below, attached as Appendix A hereto.

(R. 622, 659-60). Additionally, petitioners' evidence questioned the materiality of and reliance by the respondents on the alleged misrepresentations and omissions. For example, the increase in LPE's 1953 sales and profits is less significant when it is noted that profits declined by more than half in the following year, and declined again in the year after that (P. Exh. 3-D(7), 3-D(8), 3-C(2), 25-C, 25-D, 25-E, III R. 59-63). In fact, it was not until 1957 that LPE showed a positive earned surplus (P. Exh. 25-F, 66-7; D.M. Exh. DD; III R. 89).

At the time of sale of the LPE-stock, there was no market for the company's shares. The book value of the stock was only $11.65 per share at year-end 1952, $29.40 in 1953, and $31.56 in 1954. By year-end 1957, it had risen only to $58.47. (D.M. Exh. DD, III R. 89.) This contrasts with the jury awards to respondents in amounts ranging from a low of $1,533 per share to a high of $2,266 per share (R. 804-07), more than forty times their original cost.

Moreover, the materiality of the alleged misstatements or omissions is questionable when looked at in connection with respondent Vertelney's right to recover. Vertelney, a business school graduate and experienced executive, was a director of LPE in September, 1953 (R. 300, 462-64, 476-78). He conceded that he found it unnecessary to discuss LPE's affairs with the Myzels since he was "staying fairly well abreast of the company's operation" (R. 314). Furthermore, the minutes of the June, 1953 Board of Directors' meeting indicate that there was considerable discussion about LPE's "present and future sales." (R. 478-80). These facts led the Eighth Circuit to comment that, "If anything, Vertelney was grossly negligent" in relying on petitioner's statements or omissions as inducements to sell his stock (A23).

In 1957 LPE contracted with Benjamin Myzel to pay him $35,000 over a nine year period for consultant services (R. 139-41). This nine-year total of $35,000 was partially in consideration for Benjamin Myzel's transfer of 255 shares of LPE to LPS in 1958 (R. 498, 506, 536).

From the time of sale (1953-1954) onwards respondents were aware of LPE's continued existence (R. 113, 187, 321, 357). Each read a 1959 newspaper article announcing the transfer of LPE from Duluth to Minneapolis (R. 113, 123-24, 187, 321, 358). There was evidence indicating Vertelney remained on LPE's Blue Cross records through 1959 and knew about LPE's expansion (R. 519-20, 715). This pattern of awareness led the court below to question the credibility of respondents' testimony, stating: "The time gap, 1953 to 1962, between the sale and the discovery of the fraud seriously bothers us not only as to Vertelney, but as to all [respondents]" (A23).

By 1958 the Levines and LPS had acquired all of the outstanding shares of LPE (R. 412-13, 420-21; D.M. Exh. A & P. Exh. 15, III R. 8-14). In 1961 Lakeside Industries, Inc. ("LII"), the corporate petitioner herein, became the successor corporation of a merger involving LPE, and LII issued 500,000 shares of its stock to the Levines in exchange for their LPE stock (P. Exh. 4; III R. 21, 122). In 1962, 150,000 shares of LII were sold to the public at $9.00 per share (R. 417, 420).

Vertelney, King and Fields instituted these actions on March 28, 1963. Cohen began his action on July 11, 1963. In each case nine years had elapsed since the alleged misrepresentations and omissions. Trial was by jury, which found in favor of the respondents and awarded damages

totaling $411,000. The trial judge denied petitioners' motion for judgment notwithstanding the verdict or a new trial (A59-A67). The Court of Appeals for the Eighth Circuit affirmed the judgments.

The Court of Appeals held that an intrastate telephone call constitutes a sufficient jurisdictional basis under Section 10(b) and Rule 10b-5; that proof of "scienter," *i.e.*, knowledge of the falsity of a statement, is not required under Section 10(b); that the doctrine of laches was not available as a defense in the action; that the respondents could recover damages measured by the difference between the consideration received and the actual value of the stock at a date substantially beyond the date of the sale; and that the petitioner corporation was liable for the individual petitioners alleged violations of Section 10(b). Thus, respondents, who originally invested $10,000 in 1946 and who sold their stock in 1953-54 for $6,400, were permitted to recover $411,000 in actions not instituted until 1963.

Reasons for Granting the Writ

A. Introduction

These cases arise solely under the private right of action which the lower courts have held is created by Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 of the Rules and Regulations of the Securities and Exchange Commission thereunder. Rule 10b-5 was promulgated by the SEC in 1942, in an effort to fill in by general rule some of the interstices in the overall scheme of Federal securities regulation. Section 10(b) makes it unlawful for any person to employ, in connection with the purchase or sale of any security, "any manipulative or deceptive device or contrivance" in contravention of SEC rules. As relevant here, Rule 10b-5 makes it unlawful, in connection

with such purchase or sale, for any person to make any untrue statements of a material fact or omit to state a material fact.

Beginning in 1946, the courts have held that there is an implied right of civil recovery for violation of Rule 10b-5. The first case, *Kardon* v. *National Gypsum Co.*, 69 F. Supp. 512 (E. D. Pa. 1946), has been followed by a series of cases applying and extending the theory. Use of the Rule has accelerated, to the point where estimates based on reported cases indicate that Rule 10b-5 is generating almost as much litigation as all the other general anti-fraud provisions of the Federal securities laws taken together, and several times as much as the express liability provisions of those laws.

Despite this extraordinary growth of a body of law that is wholly judge-made, this Court has never considered Rule 10b-5 or its scope, although a number of occasions have arisen in which petitions for certiorari have been filed in cases arising under the Rule. In *List* v. *Lerner*, O.T. 1965, No. 66, the SEC appeared as amicus curiae in the certiorari proceedings at the request of the Court. Although the SEC in that case did not believe the writ should issue, as the principal question had been decided correctly and the case involved primarily factual questions, the brief stated (p. 5):

> "The issues have many ramifications, and they may arise in a wide variety of factual situations. They have become more important in recent years, since Section 10(b) and Rule 10b-5 have been relied on with increasing frequency by the Commission to prevent deceptive activities by purchasers of securities and by private parties to secure redress for such activities. This Court has not yet interpreted these

> provisions, and a decision by it would provide helpful guideposts in the development of this important area of the law." (footnote omitted)

The principal interpretive questions in the present case are basic to almost every private action under Rule 10b-5. These are (1) whether proof is required that a misstatement relied on to establish liability has been made with knowledge that it is untrue; that is, whether an innocent misrepresentation is actionable under the Rule; (2) what is the correct rule of damages to apply in an action brought under the Rule by a seller of securities; and (3) whether laches is available as a defense in such an action. These issues, and the others raised in this petition, have been decided in varying ways by the lower courts, which have recognized that conflicts exist among the Circuits. There appears, therefore, the most compelling reason for granting this petition for certiorari—different rules of Federal law now apply in different areas of the nation, and only this Court can prevent the evils of forum-shopping and uneven treatment of litigants in an important area of the law.

Moreover, the decision below has significant impact on petitioners, who have been subjected to a judgment of $411,000, including a judgment of $212,000 in favor of respondent Vertelney, who the court found had been, if anything, "grossly negligent." One of the petitioners held liable in this case is Lakeside Industries, Inc., a publicly held corporation which received no tangible benefit from the putative violation of Rule 10b-5. Thus, the present case not only presents issues of general importance to the administration of the Federal securities laws, it is itself a striking illustration of the need for this Court to formulate proper standards in this type of litigation.

B. The Decision Below Conflicts with the Landmark Decision of the Second Circuit in *Fischman* v. *Raytheon Mfg. Co.* in Holding Erroneously that Proof of "Scienter" is Not Required in an Action Under Rule 10b-5

The court below held that "Proof of 'scienter,' i.e., knowledge of the falseness of the impression produced by the statements or omissions made, is not required under Section 10(b) of the Act." (A19.) This holding is in direct and irreconcilable conflict with the decision of the Second Circuit in *Fischman* v. *Raytheon Mfg. Co.*, 188 F. 2d 783 (1951), where the court, in a carefully-reasoned opinion of first impression, held that proof of fraud is required in an action under Rule 10b-5. The decision below is also in conflict with *Trussell* v. *United Underwriters, Ltd.*, 228 F. Supp. 757 (D. Colo. 1964) and *Parker* v. *Baltimore Paint and Chemical Corp.*, 244 F. Supp. 267 (D. Colo. 1965).

The opinion in the court below obscures the issue of "scienter" by confusing knowledge of the falsity of a representation with the intent with which the representation is made. As the court noted, the District Court's charge to the jury required a finding of "misrepresentations or omissions" made with "the intent of inducing plaintiffs to sell their stock." (A19.) An innocent misrepresentation can be made with such an intent, however, if the person making the representation has an erroneous belief in the truth of the statement or omission and it is made in the context of inducing a securities transaction. In those circumstances, there would be no fraud—*i.e.*, no "scienter"—and no cause of action under the rule adopted by the Second Circuit in *Fischman* v. *Raytheon Mfg. Co.* The court below, on the other hand, concluded that a finding of intent to induce the purchase of stock required "in effect" a finding that the petitioners be "conscious wrongdoers." There is no sup-

port whatever in the charge for this conclusion. The charge plainly permitted the jury to find liability if there was a material misstatement or omission, without requiring any finding that the defendants were aware of the falsity of the statement or had any intent to defraud the plaintiff. (See R. 782, 786.)

In holding that "proof of scienter . . . is not required under Section 10(b) of the Act," the court followed *Ellis* v. *Carter,* 291 F. 2d 270 (9th Cir. 1961), which adopted the principle that misrepresentations, to be actionable under Rule 10b-5, need not be knowingly made. The rule that has emerged in the Eighth and Ninth Circuits, therefore, stands in opposition to that adopted in 1951 by the Second Circuit and consistently followed since in that court, which as a commercial and financial center deals with a significant number of all actions brought under Rule 10b-5. See, *e.g., Weber* v. *C.M.P. Corp.,* 242 F. Supp. 321 (S.D.N.Y. 1965); *Thiele* v. *Shields,* 131 F. Supp. 416, 419 (S.D.N.Y. 1955); cf. *Richland* v. *Crandall,* 262 F. Supp. 538, 553 n. 12 (S.D. N.Y. 1967). There seems no likelihood that the conflict among the circuits can be resolved without intervention by this Court. The writ should be granted so that this Court can settle the issue, which is of vital importance not only in the present case, but in every case brought under Rule 10b-5.*

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* The Tenth Circuit in *Stevens* v. *Vowell,* 343 F. 2d 374 (1965), may have indicated agreement with the Ninth Circuit in not requiring proof of scienter. The confusion in this area and the need for clarification by this Court, however, is illustrated by *Parker* v. *Baltimore Paint and Chemical Corp.,* 244 F. Supp. 267 (D. Colo. 1965), a later case arising in the Tenth Circuit. The court in *Parker* considered the *Stevens* consideration of the "scienter" question as dictum and reaffirmed the District Court's prior decision in *Trussell* v. *United Underwriters, Ltd.,* 228 F. Supp. 757 (D. Colo. 1964), which analyzed the issue at length and held that scienter is an essential element of an action under Rule 10b-5.

Determination of whether "scienter" should be required under Rule 10b-5 requires an examination of the system of securities regulation imposed under the several Federal securities laws. The opinion in *Fischman* v. *Raytheon Mfg. Co.* was written by Circuit Judge Frank, himself a former Chairman of the Securities and Exchange Commission. Judge Frank's conclusion rests on a compelling analysis of the Congressional policies embodied in the securities laws themselves. Indeed, even the SEC release announcing the adoption of Rule 10b-5 stated that the rule prohibited "individuals or companies from buying securities *if they engage in fraud in their purchase.*" (SEC Sec. Exch. Act Rel. No. 3230, May 21, 1942; emphasis added.)

The conflict between the Second and Ninth Circuits has been recently recognized by Judge Wyatt of the United States District Court for the Southern District of New York, who found that the rule in *Fischman* v. *Raytheon Mfg. Co.* is still binding in the Second Circuit, and that *Ellis* v. *Carter* "reaches a contrary result" on the issue of whether misstatements which might be innocent or negligent are actionable under Rule 10b-5. *Weber* v. *C.M.P. Corp.*, 242 F. Supp. 321 (S.D.N.Y. 1965). The result in *Ellis* v. *Carter* is, of course, exactly the result reached by the Eighth Circuit in the present case. Judge Wyatt summarized the issue, and the reasons for the Second Circuit rule, this way (242 F. Supp. at p. 325):

> "But were I free to do so, I would not follow *Ellis* v. *Carter* which, with great deference, seems to me (on the specific point under discussion) to be in error. The 1933 and 1934 Acts are closely related, were adopted close together in point of time, and

were part of the same legislative program. The first Act dealt primarily with the distribution of securities; the second Act dealt primarily with securities transactions after initial distribution had been made. To give a private remedy under Rule 10b-5 and Section 17(a) is simply to duplicate (without their restrictions) the express liabilities created by Sections 11 and 12 of the 1933 Act *unless* the remedy under Section 17(a) and Rule 10b-5 be made different. The *Fischman* decision at least recognized this aspect and did something about it. The *Fischman* decision says that if you rely solely on innocent or negligent misstatements, your sole remedy is under Sections 11 and 12 of the 1933 Act with the short statute of limitations and other procedures laid down by Congress. If you wish to avoid those limiting procedures, you must allege and prove real fraud, that is, scienter. Such an analysis seems far more reasonable to me than the broad generality of *Ellis* v. *Carter.*"

The facts in the present case provide an excellent opportunity for this Court to examine this issue of "scienter," since it is of critical importance in this case in determining liability. There was conflicting testimony with respect to substantially all the alleged misrepresentations and omissions involved; it must be remembered that the statement of the case by the Court of Appeals in its opinion assumes all factual issues as having been resolved against the defendants. On the evidence, however, the jury might have found that petitioners made statements about the financial condition of LPE, that these statements were not accurate but that petitioners honestly believed them to be true, and that these were the only misrepresentations or omissions involved. Under the District Court's charge, the jury was

required to base liability solely on that finding. Under *Fischman* v. *Raytheon Mfg. Co.* and *Trussell* v. *United Underwriters, Ltd., supra,* the finding would not establish a violation of Rule 10b-5.

Moreover, the issue of scienter should in this case determine whether the action can be maintained at all. Respondents brought these actions against petitioners in 1962 and 1963, almost ten years after the acts complained of were allegedly committed. The statute of limitations would plainly have run, were it not for the rule of *Bailey* v. *Glover,* 21 Wall. 342 (1875), which tolls the statute until plaintiff has discovered or should reasonably have discovered the fraud. The *Bailey* rule applies, however, only where there has been fraud or concealment; see *Traer* v. *Clews,* 115 U.S. 528 (1885). Thus, the jury should have been instructed that if no scienter were found, the action is barred by the statute of limitations.

A number of commentators have indicated that the view of the Second Circuit, or a rule which requires some degree of scienter to establish liability, is the correct one. See, *e.g.,* Fleischer, *"Federal Corporation Law": An Assessment,* 78 Harvard Law Review 1146, 1178 (1965); 3 Loss, Securities Regulation 1766 (2d Ed. 1961, and 1962 Supplement); Note, 63 Michigan Law Review 1070 (1965). With this support for the Second Circuit's approach, the conflict among the Circuits will be perpetuated indefinitely unless this Court grants the petition for certiorari and resolves the issue.

C. The Decision Below Adopts an Erroneous Standard of Federal Law with Respect to the Measure of Damages, in Conflict with Decisions of Other Courts and with Section 28(a) of the 1934 Act

The courts below erred in permitting recovery by the sellers of an amount greater than the difference between the value of the stock at the time of the sale and the amount of consideration received. The measure of damages allowed by the court permitted the jury to consider later accretions in value, a standard which permits a plaintiff to initiate suit after waiting until the moment of maximum speculative advantage occurs. This holding conflicts with *Estate Counseling Service* v. *Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 303 F. 2d 527 (10th Cir. 1962), which held that the measure of damages in an action under Rule 10b-5 is the "out-of-pocket" rule.

In fashioning an implied right of action under the general standards of Rule 10b-5, the lower courts have created, and are creating, a body of Federal corporate common law, much like the development of Federal law before *Erie R.R.* v. *Tompkins*, 304 U.S. 64 (1938). The measure of damages historically adopted in Federal cases involving common law actions for fraud and deceit has been the "out-of-pocket" rule. *Smith* v. *Bolles*, 132 U.S. 125 (1889). As this Court stated in *Sigafus* v. *Porter*, 179 U.S. 116, 123 (1900), quoting from an earlier decision of the Eighth Circuit, "The true measure of the damages suffered by one who is fraudulently induced to make a contract of sale, purchase, or exchange of property, is the difference between the actual value of that which he parts with and the actual value of that which he receives under the contract. It is the loss which he has sustained, and not the profits which he might have made by the transaction. It excludes all speculation, and is limited to compensation."

Estate Counseling Service v. *Merrill Lynch, Pierce, Fenner & Smith, Inc., supra,* held that this common law rule is still applicable in actions under Rule 10b-5, as did the court in *Kohler* v. *Kohler Co.*, 208 F. Supp. 808 (1962), aff'd, 319 F. 2d 634 (7th Cir. 1963). See also 3 Loss, Securities Regulation 1793 (1961), which accepts the out-of-pocket rule as the proper measure of recovery in a Rule 10b-5 case.

The broader remedy permitted by the court below is derived from *Janigan* v. *Taylor,* 344 F. 2d 781 (1st Cir.), *cert. denied,* 382 U.S. 879 (1965). The court in *Janigan* posed the issue as whether to grant a "necessary" windfall to the "conscious wrongdoer" or to the party defrauded. Based on this simplistic choice between the innocent victim and the knowing defrauder, the court in *Janigan* made the rather obvious decision. But the *Janigan* rule is one which is specifically applicable only to "conscious wrongdoers." As urged in this petition, the instructions to the jury in this case permitted the finding of a violation of Rule 10b-5 without a finding of "scienter." See pp. 11-12, *supra.* The *Janigan* rule is thus inapplicable to the facts and posture of this case, and in adopting that rule the court below erred.

Moreover, the allowance of damages in an amount greater than that permitted under the "out-of-pocket" rule conflicts with Section 28(a) of the Securities Exchange Act of 1934, 15 U.S.C. § 78 bb, which specifically establishes the outer limits of recovery in an action under Rule 10b-5. Section 28(a) provides that "no person permitted to maintain a suit for damages under the provisions of this title shall recover . . . a total amount in excess of his actual damages on account of the act complained of." The court below stated, ". . . we feel the only effect of this provision is to prohibit punitive damages . . . ," and permitted a re-

covery greater than that of the "out-of-pocket" standard. This decision conflicts with the Federal rule adopted by other courts. See *Estate Counseling Service* v. *Merrill Lynch, Pierce, Fenner & Smith, Inc., supra,* 303 F.2d at p. 533, and *Kohler* v. *Kohler Co., supra,* 208 F. Supp. at p. 825. These cases squarely hold that Section 28(a)'s language of "actual damages" incorporates the "out-of-pocket" measure of recovery.

D. The Decision Below Rejecting the Defense of Laches in a Rule 10b-5 Case is in Conflict with the Decisions of Other Courts

The court below erred in holding that the defense of laches was not applicable to a Rule 10b-5 cause of action "properly tried at law to a jury." (A35.) The ruling is in conflict with the decisions of other courts. See *Royal Air Properties, Inc.* v. *Smith,* 312 F. 2d 210, 214 (9th Cir. 1962); *Tobacco and Allied Stocks* v. *Transamerica Corp.,* 143 F. Supp. 323 (1956), aff'd 244 F. 2d 902 (3d Cir. 1957); *Pitofsky* v. *Brucker,* (S.D.N.Y. 1966) CCH Federal Securities Law Reporter, par. 91,715 (1964-66 Transfer Binder). The Ninth Circuit in *Royal Air Properties, Inc.* squarely held that in a Rule 10b-5 action laches was an available defense. The District Court in *Tobacco and Allied Stocks* concurred and additionally decided that laches was an appropriate defense whether the claim is characterized as one in law or equity, such a characterization being deemed by the court to be an unnecessary throwback to common law pleading rules. See *Tobacco and Allied Stocks* v. *Transamerica Corp.,* 143 F. Supp. at 327.

The court below prohibited the laches defense on the ground that the nature of the claims was one at law. This characterization was made despite the fact that the plain-

tiffs claimed alternatively damages at law and rescission in equity. Moreover, the equitable defense of laches was considered inapplicable despite the fact that the ultimate relief granted was equitable, *i.e.*, the *Janigan* rule of permitting the one defrauded to keep any windfall as a result of accretions to the value of stock after the date of sale.

The court below relied on *Straley* v. *Universal Uranium & Milling Corp.*, 289 F. 2d 370 (9th Cir. 1961), an action brought under Sections 5 and 11 of the Securities Act of 1933, 15 U.S.C. 77a, *et seq.*, both of which are governed by a statutory period of limitations. Rule 10b-5, however, contains no statutory limitations period. The Ninth Circuit itself in *Royal Air Properties, Inc., supra,* refused to follow its earlier decision in *Straley,* stating, " . . . where there is no applicable federal statute of limitations, as in a Section 10(b) action, there is no evidence of a Congressional intent to exclude the traditional doctrine of laches." 312 F. 2d at p. 214.

E. The Decision Below that an Intrastate Telephone Call Supports Federal Jurisdiction is in Conflict with the Decisions of Other Courts

Section 10(b) and Rule 10b-5 provide that "the use of any means or instrumentality of interstate commerce or of the mails . . ." constitutes a basis for federal jurisdiction. The court below, relying upon *Nemitz* v. *Cunny,* 221 F. Supp. 571, 573 (N.D. Ill. 1963), held that the use of a telephone to call another wholly within the same state constitutes sufficient jurisdiction because the telephone is an "instrumentality of interstate commerce." The decision below and the rule of *Nemitz* conflict with the holding in *Rosen* v. *Albern Color Research, Inc.* 218 F. Supp. 473 (E.D. Penn. 1963). See also Note, 62 Mich. L. Rev. 1080 (1964).

The Court in *Rosen*, citing Mr. Justice Holmes's analysis in *Minneapolis & St. Louis R.R. Co.* v. *Winters*, 242 U.S. 353, 357 (1917), reasoned that whether an object is to be considered an "instrumentality of interstate commerce" depends entirely upon the use to which it is put. In the context of a telephone, the test therefore would be whether the call was to another within the state or whether it was indeed used in interstate commerce.

The question has often arisen before the Federal courts. See *Bredehoeft* v. *Cornell*, 260 F. Supp. 557 (D. Ore 1966); *Lennerth* v. *Mendenhall*, 234 F. Supp. 59 (N. D. Ohio 1964); *Repass* v. *Rees*, 174 F. Supp. 898 (D. Colo. 1959).

Although the court below also predicated jurisdiction on the "delivery of checks written by the Illinois Corporation on Chicago, Illinois banks to a Minnesota citizen," the trial court's instructions to the jury permitted a finding that petitioners used merely the telephone to purchase respondent's stock (R. 785-786). Thus, jurisdiction could well be predicated on the use of the telephone alone. Petitioners urge this court to grant certiorari in order to settle this conflict among the courts.

F. The Assertion of Liability Against the Corporate Defendant Conflicts with Applicable Law

The court below held that Lakeside Industries, Inc., as the successor to LPE, is liable for the individual defendants' alleged violations of Rule 10b-5. LII's liability is predicated on misrepresentations or omissions made by a stockholder or director of LPE solely for his own benefit and not for that of the corporation. LPE had no concern over who owned its shares at the time of the sales by respondents. Imposing liability on LII, as successor to LPE, conflicts with the well-established rule that a corpo-

ration is not liable for misrepresentations or omissions made by an officer or director in connection with the selling or buying of stock in the corporation for the officer or director's own personal account. See *Kohler* v. *Jacobs,* 138 F. 2d 440, 443 (5th Cir. 1943), 10 FLETCHER, CYCLOPEDIA CORPORATIONS §4886 p. 506; RESTATEMENT OF RESTITUTION, §142 (1937).

Since 1962, 150,000 additional shares of LII have been issued to the public. The alleged acts of the individual petitioners were the acts of former stockholders of LPE and not those of the corporation. To penalize the corporation and all its public stockholders for the acts of these particular stockholders is a novel and inequitable notion.

G. The Holding Below that a Grossly Negligent Plaintiff Can Recover Under Rule 10b-5 Conflicts with the Second Circuit Decision in *List v. Fashion Park, Inc.*

Respondent Vertelney was found by the Court of Appeals to have been, if anything, "grossly negligent." (A23)

The holding below that Vertelney nevertheless could recover, even though grossly negligent, conflicts with *List* v. *Fashion Park, Inc.,* 340 F. 2d 457 (2d Cir.), *cert. denied,* 382 U.S. 811 (1965). *List* held that the reliance necessary for an action under Section 10(b) is not only that the plaintiff in fact relied upon the misrepresentation, but that "a *reasonable man* would also have acted upon the fact misrepresented." 340 F. 2d at p. 462. Since Vertelney was an experienced man with a degree in business administration, and a director of LPE at the time of the alleged misstatements and omissions, he could not in these circumstances be said to have reasonably been misled or to have relied upon the alleged misstatements.

In addition, the District Court charged correctly that Vertelney, because of his position as a director, was an "insider" as a matter of law. An insider who sells his stock cannot recover under Section 10(b) where his claim is based on facts which were equally available to both buyer and seller. Cf. *Hafner* v. *Forest Laboratories, Inc.*, 345 F. 2d 167 (2d Cir. 1965). Furthermore, because of his position as a director, and his presence at relevant directors' meetings, where the nature of the business and its prospects were thoroughly discussed, Vertelney, as a matter of law, was on notice as to any falsity in any of the alleged representations or omissions. It cannot be said that one who has notice of any such falsity meets the criterion of reliance upon material facts which are "misleading" within the meaning of Rule 10b-5. Any misstatements or omissions could not reasonably have been material to or relied on by a man with Vertelney's experience and admitted personal knowledge of the corporation's affairs. When liability is imposed under the circumstances present in this case, Rule 10b-5 becomes a trap for the unwary. In granting Vertelney's claim for damages, the court below committed reversible error.

CONCLUSION

The decision below conflicts on numerous issues with decisions in other Federal courts. This Court has never considered the many questions arising under Rule 10b-5. The increasing frequency of cases arising under the Rule, and the uncertainty which now pervades this area of the law, point to the urgent need for this Court to resolve these issues at this time.

For the foregoing reasons, this petition for a writ of certiorari should be granted.

Respectfully submitted,

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January 8, 1968

APPENDIX A

Opinion of United States Court of Appeals

UNITED STATES COURT OF APPEALS

FOR THE EIGHTH CIRCUIT

No. 18,341

Benjamin (Benn) Myzel, et al., Appellants,

v.

Harry Fields, Appellee.

No. 18,342

Benjamin (Benn) Myzel, et al., Appellants,

v.

Samuel H. King, Appellee.

No. 18,343

Benjamin (Benn) Myzel, et al., Appellants,

v.

Rita Vertelney, Special Administratrix, etc., Appellee.

No. 18,344

Benjamin (Benn) Myzel, et al., Appellants,

v.

Gordon M. Cohen, Appellee.

Appeals from the United States District Court for the District of Minnesota

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[October 12, 1967.]

Appendix A—Opinion of United States Court of Appeals

Before MATTHES, MEHAFFY and LAY, Circuit Judges.

LAY, Circuit Judge.

The four cases here considered are actions brought under Securities and Exchange Commission Rule 10b-5, 17 C.F.R. §240.10b-5 (hereinafter Rule 10b-5), which implements Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. §78a et seq., arising out of the sale of stock of a closed corporation. Trial was held before a jury and jury verdicts totaling $411,000 were returned in favor of the plaintiffs.[1] Honorable Earl Larson, the trial judge, overruled the defendants' motion for new trial and judgment notwithstanding the verdict. The defendants have appealed. We affirm the verdicts and judgment below.

The basic issues are: (1) jurisdiction over intrastate sales, (2) sufficiency of the evidence to support the verdicts, (3) the liability of "controlling" persons and (4) the proper measure of damage.

I. JURISDICTION. Both Section 10 of the Act (15 U.S.C. §78j(b)) and Rule 10b-5 require as a jurisdictional basis "the use *of any means* or *instrumentality of interstate commerce* or *of the mails,* or of any facility of any national securities exchange."

The evidence is undisputed that the telephone was used only on an intrastate basis in the solicitation or purchase of each of the appellees' stock. Appellees claim that fed-

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[1] Plaintiff Rita Vertelney is suing in her capacity as special administratrix for the estate of her deceased husband, Joseph, who was originally a plaintiff.

eral jurisdiction exists because the telephone is an "instrumentality of interstate commerce" and, therefore, the cases fall within the prohibition of the statute. Despite reasoning to the contrary,[2] we are convinced that Congress,

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[2] See *Rosen* v. *Albern Color Research, Inc.*, 218 F.Supp. 473 (E.D. Pa. 1963). The *Rosen* case relies upon *Northern Trust Co.* v. *Essaness Theatres Corp.*, 103 F.Supp. 954 at 964 (N.D. Ill. 1952), wherein the district court states:

> "The purpose of Section 17(a) of the 1933 Act and Section 10(b) of the 1934 Act are similar and the phraseology employed is substantially similar."

Section 17(a) of the Securities Act of 1933, 15 U.S.C. §77q(a), provides in part:

> "It shall be unlawful for any person in the offer or sale of any securities by the use of any means or instruments of transportation or communication in interstate commerce or by the use of the mails, directly or indirectly. . . ."

Judge Kraft in the *Rosen* opinion reasons that it is the interstate communication which is the essence of the offense. Despite the similarity there is a crucial omission from §10(b) of the §17(a) requirement that there be a communication *in* interstate commerce; the requirement of §10(b) is "by the use of any means or instrumentality *of* interstate commerce." The legislative history does not serve to explain the difference in the wording of the two statutes. As we indicated in *Little* v. *United States*, 331 F.2d 287, 292-93 (8 Cir. 1964), the use of the mails is not the gist of the offense:

> "That the scheme to defraud is the evil intended to be controlled and remedied by passage of the Securities Act, supra, cannot be in doubt. . . ."

See also *Creswell-Keith, Inc.* v. *Willingham*, 264 F.2d 76, 80, 82 (8 Cir. 1959). All the other sections of the Securities Exchange Act of 1934 incorporate similar language, as does the Act controlling investment companies, 15 U.S.C. §80a-1. In each case the language reads "use of the mails and means and instrumentalities *of* interstate commerce." The Supreme Court when faced with an analogous argument under Section 605 of the Communications Act of 1934, 47 U.S.C. §605, stated:

> "In making the alterations in the phraseology of the similar section of the earlier act the Congress must have had some purpose." *Weiss* v. *United States*, 308 U.S. 321, 329 (1939).

in the interest of fairly regulating interstate commerce, intended to supervise those intrastate activities in violation of Rule 10b-5 which are "inimical to the welfare and public policy of the country as a whole." *Nemitz* v. *Cunny*, 221 F.Supp. 571, 574 (N.D. Ill. 1963). We hold, consequently, that intrastate use of the telephone comes within prohibition of the Act. See also *Bredehoeft* v. *Cornell*, 260 F.Supp. 577 (D. Ore. 1966); *Lennerth* v. *Mendenhall*, 234 F.Supp. 59 (N.D. Ohio 1964). In interpreting other grants of federal power, it has long been acknowledged that Congress may regulate intrastate activity if simultaneously it is an integral part of or constitutes an instrumentality of interstate commerce. *Alstate Constr. Co.* v. *Durkin*, 345 U.S. 13 (1953); *Overstreet* v. *North Shore Corp.*, 318 U.S. 125 (1943); *Pedersen* v. *Delaware, L. & W. R.R. Co.*, 229 U.S. 146 (1913). Thus, in order to protect interstate commerce, intrastate telephonic messages have been placed under the statutory prohibition pertaining to unauthorized publication or use of communications under 47 U.S.C. §605. *Weiss* v. *United States*, 308 U.S. 321 (1939). We recognize that the telephone system and its voice transmission by wire is an integrated system of both intrastate and interstate commerce. Cf. *Lipinski* v. *United States*, 251 F.2d 53 (10 Cir. 1958). As such, proof of the interstate telephonic message is not a prerequisite to jurisdiction over a Section 10(b) action. As long as the instrumentality itself is an integral part of an interstate system, nothing in the Constitution requires Congress to exclude intrastate activities from its regulatory control. See *Weiss* v. *United States*, supra.

But there exists additional grounds to sustain jurisdiction. It is the rule that where any interstate use is made to perpetuate the original fraudulent concealment or transaction, even though not part of the original solicitation or inducement of sale involved, that nevertheless the subsequent use of interstate facilities in furthering the scheme is sufficient to establish federal jurisdiction.[3] *Creswell-Keith, Inc.* v. *Willingham,* 264 F.2d 76, 80, 82 (8 Cir. 1959); see also *Thomas* v. *United States,* 227 F.2d 667, 670 (9 Cir. 1955) [use of automobile]; *Ellis* v. *Carter,* 291 F.2d 270, 274 (9 Cir. 1961) [use of plane]; cf. *Boone* v. *Baugh,* 308 F.2d 711 (8 Cir. 1962).

Appellees contended that they were fraudulently induced to sell their stock to the appellants, that the purchases were made by parties (the Myzels) other than the true buyers (the Levines) and that an Illinois corporation owned by some of the appellants was used as a conduit of concealment. The transfers of the stock to the Illinois corporation, although occurring several months and even years later, involved the delivery of checks written by the Illinois corporation on Chicago, Illinois banks to a Minnesota citizen. Cf. *Little* v. *United States,* 331 F.2d 287 (8 Cir. 1964). Thus, under appellees' theory, there was also sufficient evidence of interstate transactions to sustain jurisdiction.

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[3] In *Pereira* v. *United States,* 347 U.S. 1, 8-9, (1954) the Supreme Court said:

> "Where one does an act with knowledge that the use of the mails will follow in the ordinary course of business, or where such use can reasonably be foreseen, even though not actually intended, then he 'causes' the mails to be used."

II. SUFFICIENCY OF EVIDENCE. By reason of the jury verdict, and in view of defendants' motion for judgment notwithstanding the verdict, we set forth from the conflicting evidence, the facts in the light most beneficial to the appellees. See, e.g. *Breeding* v. *Massey,* 378 F.2d 171 (8 Cir. 1967).

Lakeside Plastics and Engraving Co., hereinafter called "LPE," was organized in 1946 in Duluth, Minnesota, by cousins, Zelmán and Clarence Levine. The company was organized as a small plastics corporation to make advertising signs. Upon its original issue there were 1,140 shares of common stock issued to some 17 persons, at a par value of $50 per share. Among the original purchasers were the appellee-plaintiffs, Harry Fields (30 shares), Joseph S. Vertelney (100 shares), Samuel H. King (30 shares), and Gordon M. Cohen (40 shares). In 1948, a sales agency, independent of LPE and entitled Lakeside Plastics Sales Co., hereinafter called "LPS," was organized in the State of Illinois by Orrin and William Levine, who were also original stockholders and directors of LPE from its inception. Both Orrin and William were brothers of Clarence Levine. From 1953 to sometime in 1957, the stock of LPE became totally vested in the hands of the four Levines and the Illinois corporation, LPS. By 1958, 640 shares of LPE were owned by LPS. At about that time, for a nominal consideration ($600 each), a one-fourth interest in LPS was sold to each of the Minnesota Levines. Then, in December 1961, the 640 shares of LPE were reacquired by LPE as treasury stock, pursuant to a merger with LPS's wholly owned subsidiary, Lakeside Properties, Inc., hereinafter called "LPI," which had received the

shares from LPS in July 1959. LPE then retired the 640 shares. The remaining 500 shares of LPE stock, then owned one-quarter each by the Levines, was in turn exchanged for 500,000 shares of a newly formed corporation called Lakeside Industries, Inc., hereinafter called "LII." In 1962, 150,000 shares of LII were offered to the public at $9 per share. The appellant-defendants herein are each of the four Levines, Benjamin Myzel, Philip Myzel and LII.

Philip (Phil) and Benjamin (Benn) Myzel, brothers and first cousins of Zelman Levine, were living in Duluth, Minnesota. The evidence shows that Benn Myzel was a close friend to each of the appellees. Benn was an early director of LPE, going off the board in 1949 and again assuming a directorship in 1954. According to the appellees, Benn Myzel originally solicited each of them to purchase stock in LPE, portraying it as an opportunity "to get in on the ground floor." Upon Benn's advice, each of the appellees made his purchase in 1946 of the shares in question at $50 par value.

For some time thereafter the growth of LPE was somewhat typical of any small, closely held corporation. From 1946 to 1951, the evidence showed a struggle for sales, a very marginal profit picture and a total lack of return to the appellee stockholders on their investment. Appellees, as well as other stockholders, expressed continued concern throughout this period as to the ultimate soundness of the investment involved. At the 1949 stockholders' meeting, appellee Fields even moved to dissolve the company in order to salvage a pro rata share of everyone's investment. LPE had an accumulated deficit in earned surplus at the end of 1951 of some $51,000. Sales in that year were $94,000. In 1952, the gross sales rose to some $249,000.

This level had been reached before, in 1948. At the end of 1952, the profit was only $7,500 for the year, whereas the earned surplus deficit was still some $43,000. This 1952 financial picture was fully disclosed at a stockholders' meeting attended by some of the appellees in June of 1953. It was also known that in 1951 a large new contract was made with the Blatz Brewing Company for advertising signs. Each of the appellees, as well as the other stockholders, in order to secure a bank loan needed for the accomplishment of this contract, was required to pledge his stock.

In the first four months of 1953, principally because of the completion of the Blatz contract, the company showed a $30,000 profit and had nearly topped the total sales of the highest previous year. In the June 1953 meeting this fact, i.e. the promising interim financial statement, dated April 30, 1953, was not disclosed nor was there any evidence or testimony reflecting discussion of this particular accomplishment. Despite the fact that the total sales in 1953 were over $541,300, almost double the figure for 1952, the total profit for the year was only $20,000 because of an alleged loss in the last eight months.[4] Never-

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[4] In ruling on post-verdict motions, the trial court made this practical observation:

> "The last eight month period covers the period of three of the stock purchases, September to December, 1953. The figures in the four month interim statement were tentative and not final. The practice of many companies assuming the available information indicates a profitable year, is to make any number of year end adjustments to reduce profits and thus reduce income taxes which must be paid in cash. The record indicates that this was done here. Defendants' repeated contention that the last eight months produced a net loss of $10,000 is not in accord with the facts or business practice." R. 904.

See also O'Neal & Derwin, Expulsion or Oppression of Business Associates: "Squeeze-Out" in Small Enterprises, c.5 (1961).

theless, in 1953 and thereafter, the sales zoomed but the profits remained slim with a reported deficit still in 1956. There were increases in salaries to the various officers, as well as increased commissions to the sales agency during this period. The first earned surplus of the company was $6,700 reported in 1957. As indicated, the total sales in 1953 doubled from 1952, and thereafter in 1954 they were increased to approximately $732,000, reaching a total of over $2,069,000 in 1957. The Levines were fully aware of the sales picture and prospects at all times. In 1958 there was $65,000 profit after taxes.

None of the appellees realized that the others had sold their LPE stock until after the reorganized company issued a prospectus in 1962. In denying the motion for judgment notwithstanding the verdict, the trial judge, Honorable Earl Larson, emphasized the failure of the purchasers in buying up the appellees' stock to disclose the April financial statement showing the $30,000 profit. As will be discussed, Benn Myzel was a close business associate of Zelman Levine. It is claimed that Benn Myzel was acting for the Levines throughout his purchases of stock from the plaintiffs in the Levines' overall scheme to obtain all of the outstanding stock of LPE. We will discuss the various representations and transactions in terms of the individual claimants.

Samuel King. King's 30 shares of stock were purchased directly by Benn Myzel in August 1953. According to King, Benn Myzel represented to him at that time that (1) the stock was not worth anything, (2) the company was making no money, and (3) Myzel had sold his own

stock. The evidence showed that King had previously sold his stock in 1950 to his employer for $200, but had bought it back because he did not want to see his employer lose any money on the transaction. It is not clear whether King approached Benn Myzel or whether Benn solicited him, but the evidence is clear that Benn did purchase the stock in August 1953, for $200. Equivalent book value of the shares at the close of 1953 would have brought King $882. The evidence shows that Benn Myzel was issued a new certificate of stock on May 26, 1954, and then this stock was retransferred to LPS on an unknown date sometime prior to December 1954. The actual date of the transfer was not shown on the certificate.

Joseph Vertelney. Vertelney had a B.S. degree in Business Administration from the University of Minnesota, and also had some experience in the buying and selling of stocks. He was first approached by Zelman Levine in August of 1953 to sell his stock. He refused. Later he was approached by Phil Myzel in September 1953. Phil admitted at the trial that at all times in the solicitation and purchase of the Vertelney stock that he was acting for his brother Benn. *This fact was not disclosed to Vertelney at any time.* Phil Myzel represented to Vertelney that the company was not going anywhere, *that his brother Benn was therefore going to get out,* and that the company was going to go bankrupt. Vertelney was a director at this time. The last meeting he attended was in June of 1953. The evidence shows that Vertelney had been active as a director in the years up to and including 1953. According to the minutes of the meetings of the corporation, he had participated in many of the business discus-

sions and transactions. At the time he was approached by Phil Myzel, Vertelney asked whether Benn knew more than he did and Phil Myzel told him, yes, but that the Levines were not telling all they knew even to Benn, suggesting that the company was actually going broke. Subsequently, Vertelney agreed to sell to Phil Myzel his stock, negotiating a price of about $35 per share, approximating $3,500.

The evidence showed that although Phil Myzel was at all times acting for Benn, nevertheless Phil Myzel did not retransfer the stock certificate to Benn until May 26, 1954. At that time, and on the same day, Zelman Levine issued a new certificate to Benn Myzel. He in turn endorsed the stock certificate to LPS, and in December 1954, another new certificate was issued to LPS representing in part the Vertelney stock. LPS at that time was owned exclusively by the two Levine brothers in Chicago, William and Orrin.

Gordon Cohen. This stock was bought by Benn Myzel in the latter part of November 1953. According to Cohen, although Benn Myzel did not represent the stock as worthless or the company in bankruptcy, he nevertheless did not offer any encouragement, and in fact represented to him that (1) the company was in a "very difficult condition," (2) it may or may not make it, (3) he (Myzel) gets nothing from the company and he was sure that Cohen would not either, and (4) that it did not look any better for the future. On this basis Cohen sold the stock to Benn, receiving $1,800 for his 40 shares. Myzel agreed to pay Cohen so much a month, and completed paying for the stock in mid-1954. The stock was transferred on the books to Benn in October 1955. This stock was assigned by

Myzel to LPS at an unknown date, but sometime before March 12, 1958, when a new certificate representing this stock was issued to LPS.

Harry Fields. His 30 shares were bought by Phil Myzel, acting undisclosed for Benn. Phil represented to Fields in early 1954, that LPE (1) was doing very badly and (2) was on the verge of bankruptcy, and on March 9, 1954, Fields sold his stock to Phil Myzel for $900. LPE issued the certificate to Phil Myzel on May 26, 1954. This was not transferred to Benn Myzel until October 20, 1955. At sometime before March of 1958, the Fields' stock was ultimately assigned to LPS along with Cohen's.

We will briefly touch upon other significant factual evidence. From August through December 1953, Benn Myzel received checks from LPS in various amounts ranging from $500 to $1,532.50 and totaling some $4,453.93. Benn Myzel expressed surprised in receiving these checks but added that they were some form of a commission paid for a favor to the Levines in getting some monies due from LPE to LPS released in connection with a factor's lien on a bank loan. Orrin Levine thought the checks were for loans extended to him. The entire matter is shrouded in contradictions by the appellants. Appellees claim the checks were commissions for buying the stock without disclosing that the true purchasers were the Levines. As the trial court observed, "the timing and the manner of payment were significant" and the proper inference was for the jury under the circumstances.[5]

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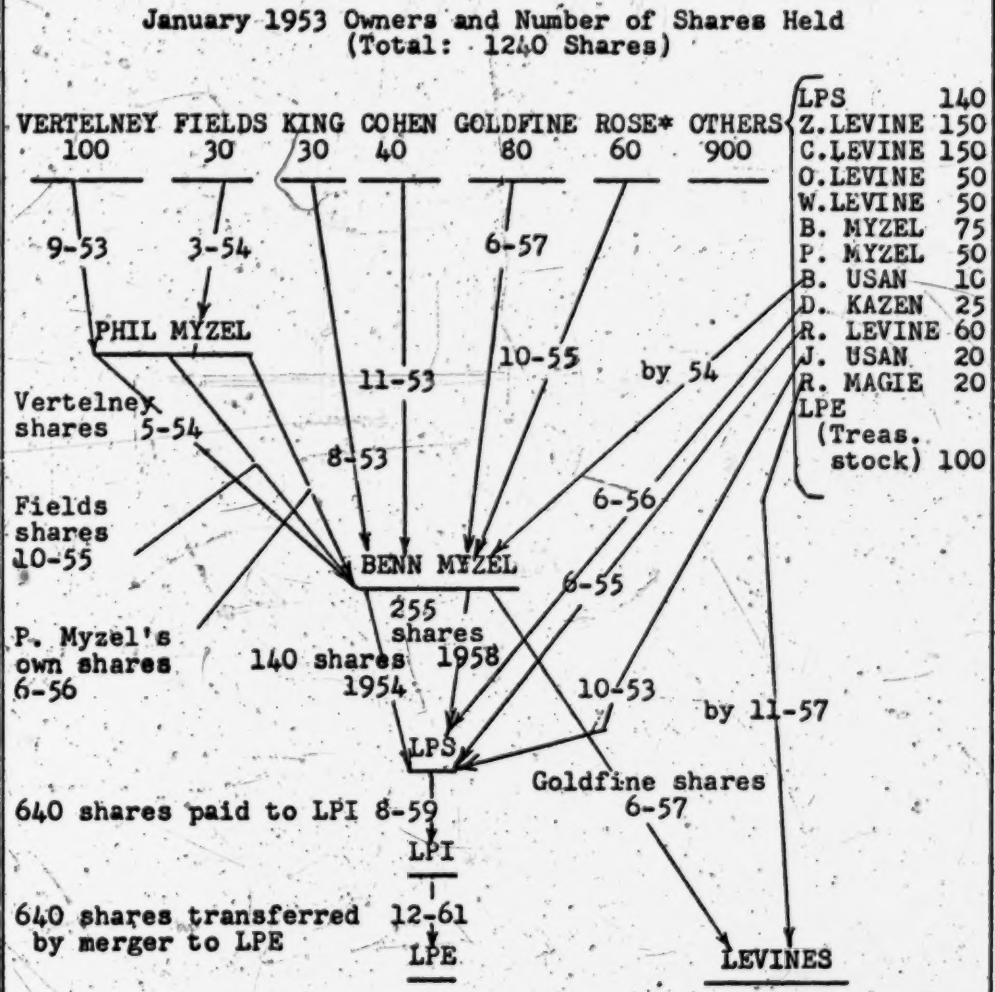
[5] It was acknowledged that in an undisclosed purchase of the Goldfine stock, discussed infra, for Zelman Levine, Benn was paid a $452 commission in 1957.

Benn's sale of all his stock to LPS was pursuant to two transactions. In the first lot involving 140 shares, he was paid approximately $10,000 by LPS, through cash and a note payable. His transfer of Vertelney's (and possibly King's) stock to LPS took place on May 26, 1954. LPS made payment of $3,750 by check, dated January 19, 1955, and a note for $7,000 executed January 5, 1955. Payments on the note, starting April 8, 1955, and continuing through December 13, 1956, totaled $7,312.37. Secondly, according to a 1958 agreement, Myzel transferred 255 additional shares to LPS in consideration of $10,000 in cash from LPS. LPS as early as June 1957 was considered to be equally owned by the four Levines. A contract for $35,000 payable by LPE was executed in June 1957 ostensibly as a fee for Benn's services as "management consultant." At the trial it was admitted by the Levines and Benn Myzel that the $35,000 was at least partially a consideration for the transfer of some of the stock involved in the March 1958 agreement with LPS.

During the period of 1953 to 1958, LPS and the Levines, through various transactions, purchased all remaining shares from all other minority stockholders. These transactions are not before us, nor do we intend the jury verdict, or our holding, in any way to reflect upon the acquisition of stock from other stockholders.

For simplification, we have charted the various acquisitions below.

HISTORY OF THE LEVINES' ACQUISITION OF 100% OWNERSHIP OF LAKESIDE PLASTICS & ENGRAVING COMPANY



* Maurice Rose acquired his brother Benjamin Rose's 30 shares on 9-7-54, giving Maurice the total of 60 shares.

In reviewing the sufficiency of the evidence in a jury trial, we said in *Commercial Union Assurance Co.* v. *Berry*, 359 F.2d 510, 516-17 (8 Cir. 1966):

> "In considering the sufficiency of the evidence, we must take that view thereof which tends to support the conclusion of the jury and must accept as established all inferences favorable to that result."
>
> . . . .
>
> "The mere possibility that the jury could have found otherwise than they did is not enough to upset its findings where such are based on substantial testimony and are not entirely unreasonable. Circumstantial evidence may point to different and opposite results. It is for the jury to say which is the correct one."

In *Lavender* v. *Kurn*, 327 U.S. 645, 653 (1946), the Supreme Court laid down the rule followed by courts of appeal.

> "Only when there is a complete absence of probative facts to support the conclusion reached does a reversible error appear. But where . . . there is an evidentiary basis for the jury's verdict, the jury is free to discard or disbelieve whatever facts are inconsistent with its conclusion."

See also *Bankers Life & Casualty Co.* v. *Kirtley*, 307 F.2d 418 (8 Cir. 1962).

The sufficiency of the evidence and the integrity of the verdict are best reviewed in the light of those cases arising under Rule 10b-5, in terms of (1) misrepresentation or nondisclosure, (2) materiality, (3) some form of scienter or intent and (4) reliance.

A. *Misrepresentation or nondisclosure.*[6] Proof of affirmative misrepresentation, generally an essential element of common law fraud, is not required in actions brought under Rule 10b-5, since the rule expressly prohibits material omissions as well. See 3 Loss, Securities Regulations 1456-65 (2d ed. 1961) (hereinafter cited as "Loss"); *Kardon* v. *National Gypsum Co.*, 73 F.Supp. 798 (E.D.Pa. 1947); *List* v. *Fashion Park, Inc.*, 340 F.2d 457, 462 (2d Cir. 1965). Cf. *SEC* v. *Capital Gains Research Bur., Inc.*, 375 U.S. 180, 201 (1963). Several undisclosed facts in the present case assume relevance when coupled with the factual statements and reckless opinions offered by the Myzels. Cf. *SEC* v. *Broadwall Securities, Inc.*, 240 F.Supp. 962, 968 (S.D.N.Y. 1965). Among facts the jury could find not disclosed in the purchases were (1) the increased sales in 1953, (2) the April 1953 interim financial statements show-

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[6] Judge Larson instructed that the appellees must prove:

> "That the defendants, or some of them, did use or employ manipulative or deceptive conduct in buying the plaintiffs' stock. More specifically, (a) that they made an untrue statement of a material fact; or (b) that they omitted to state a material fact which was necessary to prevent statements they did make from being misleading; or (c) that they failed to disclose a known fact which was not available to the plaintiffs and which they should reasonably have known would be important to the plaintiffs in determining the value of the stock which the plaintiffs held."

Subsection (c) of the court's instruction seemingly goes beyond subsection (2) of Rule 10b-5. No issue is raised by appellants whether nondisclosures to be actionable under Rule 10b-5 must of "necessity" be related to affirmative statements. Unless subsection (3) of the rule encompasses bare nondisclosed facts, this requirement may be necessary to qualify nondisclosures as manipulative or deceptive under Section 10. Compare 3 Loss 1766. On the other hand, material nondisclosures without accompanying statements have been held actionable; see e.g. *Cady, Robert & Co.*, 40 S.E.C. 907, 913, and discussion thereof in 52 Iowa L.Rev. 777, 781 (1967).

ing the successful Blatz contract and $30,000 profit, (3) the potential of 1954 sales or at least Zelman Levine's (President of LPE) optimism over prospects for the future and (4) the identity of the controlling purchasers.

B. *Materiality.*[7] These nondisclosures assume materiality when considered in the context of the affirmative representations made severally to the appellees. Phil Myzel's statement to Vertelney that Benn was "going to get out" of the company could be considered actionable as a misstatement of another's intent or state of mind. See Restatement of Torts §530 and §525, comment b (1938). Benn's statements to King that he himself had sold his stock, that it was worthless and that the company wasn't making any money were misleading. See, e.g., *Janigan* v. *Taylor,* 344 F.2d 781 (1 Cir. 1965); cf. *Rogen* v. *Ilikon Corp.,* 361 F.2d 260, 266-67 (1 Cir. 1966). Phil's statements to Fields that the company was on the "verge of bankruptcy" or "in bad shape" were material in view of the nondisclosures. And Benn's statements to Cohen that "he was not getting any money from the company" become significant with the discovery of Benn's commissions commencing in August 1953. Evidence that Benn consistently avoided mentioning his continued possession of the stock or his directorship in LPE and that when questioned by appellee Fields in 1955 he responded, "it's a

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[7] The court instructed the jury that appellees, in order to recover, must prove:

> "That the misrepresentations or omissions, if any, [must be] concerned or related to a material fact or facts. A fact or omission of fact is material if it concerns something that a reasonable man would consider important in deciding what he should do in a particular transaction."

good thing we got out of it," was undoubtedly damaging to his credibility.

Materiality encompasses those facts "which in reasonable or objective contemplation might affect the value of the corporation's stock or securities . . ." to the seller. *Kohler* v. *Kohler Co.*, 319 F.2d 634, 642 (7 Cir. 1963). See also *List* v. *Fashion Park, Inc.*, supra. But it also should be considered that material information "need not be limited to information which is translatable into earnings. . . ." *SEC* v. *Texas Gulf Sulphur Co.*, 258 F.Supp. 262, 280 (S.D.N.Y. 1966).

A sale of stock preceded by a statement that business was "about the same" was sufficient to sustain a Rule 10b-5 action by stockholders and directors against another director in *Janigan* v. *Taylor*, supra, 344 F.2d at 785. The court said:

> "Viewed against a background of past fluctuations, we might not find the misrepresentation to be of the importance intimated by the court's opinion. *Certainly it could not be claimed that the change presaged the dramatic improvement that occurred subsequently in the company's affairs, or that the defendant could have any thought that it did.* On the other hand, even as a new upswing not uncharacteristic of the business, plus some promising overtones, we could not find that as a matter of law the true situation was fairly disclosed, within the heavy requirements of the Act, by the single statement that things were 'about the same.'" (Our emphasis)

Under the circumstances the jury had a right to consider whether the estimates of LPE's financial prospects uttered

by both Myzels were given in bad faith for the purpose of misleading.[8]

C. *Scienter.* Proof of "scienter," i.e., knowledge of the falseness of the impression produced by the statements or omissions made, is not required under Section 10(b) of the Act. In *Dale* v. *Rosenfeld,* 229 F.2d 855, 858 (2 Cir. 1956), the court of appeals said: "Readiness and willingness to disclose are not equivalent to disclosure." See also *Ellis* v. *Carter,* supra, 291 F.2d at 274; *SEC* v. *Texas Gulf Sulphur Co.,* supra, 258 F.Supp. at 277. However, under the court's instructions the jury was required to find "deceptive or manipulative conduct" consisting of "misrepresentations or omissions" made with "the *intent* of inducing plaintiffs to sell their stock." By this phrasing, which in fact was more demanding than the broader express terms of the statute and the rule, the jury was in effect told that appellants had to be found conscious wrongdoers before liability ensued. We fail to see any prejudice to appellants here.

D. *Reliance.*[9] Professor Loss points out that in cases of nondisclosure, if reliance is a prerequisite of a Rule 10b-5

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[8] The trial court instructed in these terms:

"Statements about the future growth and development of a company are classed as opinions or facts, depending upon the circumstances under which they were made. No recovery may be based on an expression of opinion by the defendants unless the opinion was completely unfounded and reckless, or unless it was deliberately intended to be misleading. The plaintiffs can also recover if you believe that the defendants gave any definite opinions or assurances about the future which they thought were false when they made them."

[9] As a prerequisite to recovery, the trial court instructed the jury:

"That the plaintiffs [must have] relied on the alleged misrepresentation or omission. There is reliance by a plaintiff if the claimed wrongful conduct was or would be a substantial factor in determining the course of conduct which resulted in the claimed loss."

action, it is "little more than a formal requirement." 3 Loss 1765. However, the Court of Appeals for the Second Circuit in *List* v. *Fashion Park, Inc.*, supra, 340 F.2d at 463, best states the rule that should govern this phase of a Rule 10b-5 suit:

> "On the other hand, we do not agree with certain overtones in the opinion of the trial court concerning the meaning of 'reliance' in a case of non-disclosure under Rule 10b-5. The opinion intimates that the plaintiff must prove he actively relied on the silence of the defendant, either because he consciously had in mind the negative of the fact concealed, or perhaps because he deliberately put his trust in the advice of the defendant. Such a requirement, however, would unduly dilute the obligation of insiders to inform outsiders of all material facts, regardless of the sophistication or naivete of the persons with whom they are dealing. . . .
>
> "The proper test is whether the plaintiff would have been influenced to act differently than he did act if the defendant had disclosed to him the undisclosed fact. *Speed* v. *Transamerica Corp.*, 99 F.Supp. 808, 829; *Kardon* v. *National Gypsum Co.*, 73 F.Supp. 798, 800 (E.D.Pa. 1947). To put the matter conversely, insiders 'are not required to search out details that presumably would not influence the person's judgment with whom they are dealing.' *Kohler* v. *Kohler Co.*, supra, 319 F.2d at 642. This test preserves the common law parallel between 'reliance' and 'materiality,' differing as it does from the definition of 'materiality' under Rule 10b-5 solely by substituting the individual plaintiff for the reasonable man."

Compare *Hafner* v. *Forest Laboratories, Inc.*, 345 F.2d 167 (2 Cir. 1965), and *Kohler* v. *Kohler Co.*, supra, with *Dale*

v. *Rosenfeld,* supra, and *Vine* v. *Beneficial Finance Co.,* 374 F.2d 627 (2 Cir. 1967).

Fields, Cohen and King were not familiar with the business. They were entirely dependent upon the advice of the Myzels when they bought and when they sold. Their uncertainty about the company, as well as their total trust in one who was not only their close friend but also a financial advisor and relative to the operators of the company, raises questions of fact that could only be resolved by the jury. Would these particular men have been impressed with the truth of the total sales picture when they were solicited to sell their stock? Would they have reacted differently had they known of the company's $30,000 profit in the first four months of the year? Would they have inflated their views of value had they known the true purchasers of the stock? All of these questions might have been answered "no" but here, upon sufficient evidence, they were answered "yes." See *Rogen* v. *Ilikon,* supra. See also Prosser, Torts §103 at 732 (3d ed. 1964):

> " 'The design of the law is to protect the weak and credulous from the wiles and stratagems of the artful and cunning, as well as those whose vigilance and security enable them to protect themselves,' and 'no rogue should enjoy his ill-gotten plunder for the simple reason that his victim is by chance a fool.' "

We are faced with a more difficult problem in the recovery of appellee Vertelney. Here was a man trained in financial matters, who was active on the Board of Directors of LPE through the June 1953 meeting. The trial court informed the jury that he was an "insider" as a matter of law. As such he presumably had superior knowledge

of the financial status of the business, as well as its prospects and business policies. As stated in *Kohler* v. *Kohler Co.*, supra, there is no duty to disclose information to one who reasonably should already be aware of it. Nor is there the necessity for one insider to "search out details" for another insider, in the same sense that such a duty might exist toward others less informed. See *Hafner* v. *Forest Laboratories, Inc.*, supra.

Hindsight reaction to an improvident sale by an insider to a stranger or even another insider, based upon nondisclosed facts equally known or available to both parties, ordinarily would not be considered within the protective basis of Rule 10b-5.[10] Cf. *Heckenkamp* v. *Kennedy*, 267 F.2d 887 (8 Cir. 1959). In *Shappirio* v. *Goldberg*, 192 U.S. 232, 241-42 (1904), it was stated:

> "When the means of knowledge are open and at hand or furnished to the purchaser or his agent and no effort is made to prevent the party from using them . . . he will not be heard to say that he has been deceived to his injury by the misrepresentations of the vendor."

If Vertelney had been misled solely by Phil Myzel's statements or nondisclosures regarding the company's value, and on that basis alone had sold his stock, recovery would be denied. On the surface, at least, he was more conversant with the financial affairs of the company than

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[10] However, such a generalization does not apply where, for example, one director has exclusive knowledge of facts affecting the value of the stock. See *Janigan* v. *Taylor*, supra, 344 F.2d at 785; *Nemitz* v. *Cunny*, 221 F.Supp. 571, 575 N.D.Ill. (1963); cf. *Staker* v. *Reese*, 82 W.Va. 764, 97 S.E. 641. See also the discussion of the "special facts" rule in 52 Iowa L.Rev. 777 (1967).

Phil Myzel. He was in a position to investigate or make an effort to inform himself as to corporate values. As a director Vertelney is chargeable with a degree of notice of those facts which the corporate books and the directors' meetings would fairly disclose.[11] *Kohler* v. *Kohler Co.*, supra, 319 F.2d at 641-42; cf. *Hafner* v. *Forest Laboratories, Inc.*, supra, 345 F.2d at 168; see also 3 *Fletcher*, Cycl. Corp. §1169 at 861-62 (1965) and 19 C.J.S., Corporations §762 at 109-10 (1940). Yet the record is silent as to any effort on his part to call Benn Myzel or the Levines or to make any valued judgment of the situation. If anything, Vertelney was grossly negligent. The time gap, 1953 to 1962, between the sale and the discovery of the fraud seriously bothers us not only as to Vertelney, but as to all of the appellees. At times the appellees' testimony joins that of appellants in taxing even the most credulous mind. Yet, we cannot usurp the traditional function of the jury as to credibility, so that when sufficient evidence appears, if the jury believes it we are bound to accept the fact-finder's verdict, even though we might have found otherwise.

However, there are circumstances involved here which we feel create a jury question as to Vertelney's naked reliance *in this particular case.* Accompanying Phil Myzel's pessimism about the financial status of LPE was the affirmative statement that Benn was "going to get out" for the reason that "he doesn't think they are going any-

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[11] There is some doubt whether a responsible role was given to other directors of LPE by the Levines. Zelman Levine stated that stockholders who were "troublemakers" were often put on the board simply to keep them quiet.

where." The evidence showed this was important to Vertelney. Here again represented was the picture of the trusted friend and advisor who had lost faith in the enterprise. When this misrepresentation is conjoined with the nondisclosure of Phil's agency for Benn, a new consideration emerges. Cf. *Strong* v. *Repide,* 213 U.S. 419, 433 (1909). The testimony of both Phil and Benn Myzel demonstrates unequivocally that Phil was making the purchase secretly for Benn. In addition, the jury could determine from all the facts that Benn was "controlled" by the Levines. Vertelney had just the month before refused to sell to Zelman Levine. As previously stated, the test of justifiable reliance in Rule 10b-5 actions is a subjective test, and not simply a "reasonable man" test. *List* v. *Fashion Park, Inc.,* 340 F.2d 457, 463 (2 Cir. 1965). By such labyrinthine transfers (see chart, supra), the true identity of the purchaser was effectively hidden from even a most alert director or insider. The jury could reasonably infer that the subsequent circuitous transfer of the stock from Phil to Benn eight months later, with immediate reassignment to LPS, then controlled by the Illinois Levines, was intended as an artifice to effectuate concealment from a person known by the appellants to be a man with business acuity.

The jury could well consider under the particular setting involved that there was created a diminished necessity in Vertelney's thinking of such inquiry as he might have made had he known that Benn or the Levines wanted to increase their holdings. Phil Myzel was a close friend of Vertelney. Although this in itself does not here, in our opinion, necessarily create a fiduciary relationship, it is a factor to be considered. See 23 Am.Jur., Fraud and Deceit

§159 at 966-67; 1 Harper & James, Law of Torts §7.8 at 563 (1956). Vertelney knew that the Levines and Benn (not Phil) were intimately involved in the success or failure of LPE. The nondisclosure of the identity of the true purchasers assumes greater significance with Vertelney than with the other appellees. He valued Benn's relationship to the Levines and knew of his early expectations and enthusiasm toward the company, for he relates, "He [Benn] is the one who pushed it so far, I would have thought that if he would get out, I better get out too." In a similar fact situation the Court of Appeals for the Second Circuit held that a concealed insider who was the true purchaser of stock ". . . was bound to disclose the facts within his knowledge which the seller would naturally want to know and would learn if not diverted from inquiry. He could, in short, deal openly and leave the seller to investigate as he chose or deal secretly and be bound to disclose the facts pertinent on the question of value." *Broffe* v. *Horton,* 172 F.2d 489, 494 (2 Cir. 1949); see also *Barnes* v. *Eastern & Western Lumber Co.,* 287 P.2d 929 at 943 (1955).

Under the circumstances we conclude, although not without great difficulty, that all of the appellees presented sufficient proof of an "assortment" of nondisclosures and positive misrepresentations to carry their respective cases to the jury.

III. LIABILITIES OF CONTROLLING PERSONS. The trial court instructed that the Levines were liable for the acts of Benn and Phil Myzel "if they knew or should have known" that the Myzels were "purchasing" the stock for the Levines "or with the intention of reselling" to them. The court referred to appellees' contention that

"a plan" existed to obtain the stock for the Levines, and added that if such existed the Levines would be liable for any fraud that the Myzels committed. The trial court emphasized that the Levines must "know and approve" of the Myzel activities in order to be liable. The court added that there could be no liability of the Levines "if they had not sought to have the Myzels obtain it."

The liability of the Levines is governed neither by principles of ageney nor conspiracy. The trial court obviously was not aided by appellees' vacillation on the conspiracy argument. Nor are we. Section 20 of the Securities Exchange Act of 1934, 15 U.S.C. §78t, reads simply:

> "(a) Every person who, directly or indirectly, controls any person liable under any provision of this chapter or of any rule or regulation thereunder shall also be liable jointly and severally with and to the same extent as such controlled person to any person to whom such controlled person is liable, unless the controlling person acted in good faith and did not directly or indirectly induce the act or acts constituting the violation or cause of action.
>
> "(b) It shall be unlawful for any person, directly or indirectly, to do any act or thing which it would be unlawful for such person to do under the provisions of this chapter or any rule or regulation thereunder through or by means of any other person."

Although it might now be argued that it would have been better to instruct in the language of the statute, neither side requested it. Appellants claim that the court should have instructed on the Levines' exculpation by reason of "good faith" or "not inducing" the acts. This argument must fail under Fed. R. Civ. P. 51, requiring specific objection at the time of trial. Hindsight argument is not helpful. In view of the given instruction, there

existed apparent justification for appellants' trial counsel not to request, but to avoid the language of the statute. The statute is remedial and is to be construed liberally. It has been interpreted as requiring only some indirect means of discipline or influence short of actual direction to hold a "controlling person" liable. See *Hawkins* v. *Merrill Lynch, Pierce, Fenner & Beane,* 85 F.Supp. 104 (W.D.Ark. 1949); *Lorenz* v. *Watson,* 258 F.Supp. 724 (E.D.Pa. 1966); *Geismar* v. *Bond & Goodwin, Inc.,* 40 F.Supp. 876 (S.D.N.Y. 1941). Cf. *Brennan* v. *Midwestern United Life Ins. Co.,* 259 F.Supp. 673 (N.D.Ind. 1966); *MacClain* v. *Bules,* 275 F.2d 431 (8 Cir. 1960); *Whittaker* v. *Wall,* 226 F.2d 868, 871-72 (8 Cir. 1955).

We are then faced with the problem whether the instruction as given was prejudicial in view of the exception appellants made at the trial. Since the language of the statute is less restrictive than the court's instruction, the statute encompasses the direction given, and no prejudice to appellant could have resulted. Cf. 3 Loss 1808-11. Furthermore, under common law principles, a principal is liable for the deceit of his agent committed in the very business he was appointed to carry out. This is true even though the latter's specific conduct was carried on without knowledge of the principal. See *Oddo* v. *Interstate Bakeries, Inc.,* 271 F.2d 417, 423 (8 Cir. 1959).

The objection appellants raised is that the instruction omits as a prerequisite to liability that under the "plan" the Levines also must know that the method to be used by the Myzels would be unlawful, relying upon common

law conspiracy cases.[12] However, where the evidence shows the "controlling person" is the actual intended beneficiary of the stock purchase, "control" under the Act does not require knowledge of the specific wrongdoing anymore than a principal must know in advance of his agent's fraud. All that is required is that the controlling person "directly or indirectly" induces the purchase. Under such circumstances, if the direct purchaser fails to disclose material information in violation of Rule 10b-5, the "controlling person" cannot excuse himself, even under the "good faith" clause of Section 20(a). To hold otherwise would vitiate the plain meaning of Section 20(b), that one cannot do indirectly through another what he cannot do himself. Therefore, even assuming argunendo, that there was failure to properly instruct under a civil or criminal conspiracy theory, the language of Section 20 obviates any possible prejudicial effect. Furthermore, the court not only required the Levines to know of Myzels' activities, but required "approval" of them, before they were responsible. Such requirements are neither explicit nor implicit in the Act. We think this qualified instruction adequately protected the rights of all appellants.

IV. "INSIDER" INSTRUCTION. The trial court charged the jury that Benn Myzel was "an insider" as a matter of law. The court then added:

> "An insider is a person who because of his position or intimate association with a corporation has greater knowledge of the financial affairs of the corporation.

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[12] However, it is well settled even under civil or criminal conspiracy that one who knowingly joins a conspiracy even at a later date takes the conspiracy as he finds it, with or without knowledge of what has gone on before. Cf. *Nassif* v. *United States*, 370 F.2d 147 (8 Cir. 1966).

> Because of his superior knowledge, an insider has a duty to disclose known facts not available to the plaintiffs and which he should reasonably have known would be important to the plaintiffs in determining the value of the stock which they held."

The court also made the definition applicable to Vertelney. The definition is accurate. The problem is its necessity and applicability.

Appellants made specific objection to the charge and renew it here. It is urged that at the very least, whether Benn Myzel was an insider is a question of fact. Section 10 and its counterpart Rule 10b-5 do not relate only to "insiders" as restrictively defined in Section 16(b) of the Act, 15 U.S.C. §78p(b). See 3 Loss 1445. Section 10(b) relates to "any person" who uses "manipulative or deceptive" practices. Proof of a purchaser's status as "an insider" is, therefore, not essential to a Rule 10b-5 violation.

Of course, if Benn Myzel was acting for or on behalf of the Levines in the stock purchase, under those circumstances he was chargeable with the duties of an insider as a matter of law. See 3 Loss 1452, n. 26. The Levines, as well as Vertelney in 1953, were all directors, and therefore may be charged with a greater knowledge of the financial condition of the corporation. But whether Benn Myzel was acting for the Levines was itself a jury question. It would have been error to charge that Benn Myzel was an insider on this theory alone.

Although it has been said that construction of Rule 10b-5 "has imposed special burdens upon insiders"[13] (see

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[13] At common law, the courts were divided on the issue whether an "insider" had a fiduciary duty of disclosure in the purchase of stock of his corporation. See 3 Loss 1446.

Cochran v. *Channing Corp.*, 211 F.Supp. 239, 242 (S.D.N.Y. 1962)), and that "the aim of . . . Rule 10b-5 is to deter misconduct of insiders . . ." (*List* v. *Fashion Park, Inc.*, supra, 340 F.2d at 463), nevertheless the expressed policy of the Act is to prevent fraud by "any person." Congress did not intend for courts to become lost in conclusory language, but to effectuate the desirable ends of the Act. See also Knauss, A Reappraisal of the Role of Disclosure, 62 Mich. L. Rev. 607 (1963-64); O'Neal, Close Corporations, §8.16 at 153 (1958); *Fischer* v. *Kletz*, 266 F.Supp. 180, 187-88 (S.D.N.Y. 1967).

As a practical matter, the rule has been applied primarily to insiders. As stated in *Kohler* v. *Kohler Co.*, supra, 319 F.2d at 642:

> "[C]orporate insiders must scrupulously disclose to outsiders those material facts about a corporation's business which in reasonable and objective contemplation might affect the value of the corporation's stock or securities and which the insiders should reasonably believe are unknown to the outsider."

See also *Speed* v. *Transamerica Corp.*, 99 F.Supp. 808, 828-29 (D.Del. 1951).

The lower court's instruction indicates that "because of [the insider's] superior knowledge" he has a duty to disclose. This is only partically accurate. Actually, his *duty* arises because of Rule 10b-5. Thus, the instruction applies regardless of the status of the person charged with violation of the Act. Therefore, the objection could only relate to the court's direction that because Myzel had "intimate association" with LPE he had, as a matter of law, "a greater knowledge of the financial affairs" of it or had "superior knowledge."

But these general facts are not really disputed by appellants. Zelman Levine and Benn Myzel both described Benn as a "financial consultant" and "advisor" to the corporation. Zelman Levine "constantly" talked business with Benn. When Zelman Levine was cross-examined we find ample description of the relationship:

> "Q. At least from a very early time he [Benn Myzel] acted—whether as a close friend or not—he did act as a surety or endorser on certain obligations of L.P.E.? A. Definitely.
>
> "Q. Almost from the very beginning of its inception? A. Yes, sir.
>
> "Q. With respect to whether he was a close friend or not—he was a blood relative—and he was also at some time a business confidant? A. Definitely.
>
> "Q. A consultant and advisor, and I assume that he intimately knew the affairs of your company? A. Yes." [14]

Where facts are undisputed and the evidence is susceptible of but a single inference, the question of one's status or relationship is one of law for the court. See, e.g., *Wooddale, Inc.* v. *Fidelity & Deposit Co. of Md.*, 378 F.2d 627, 630-31 (8 Cir. 1967).

Objection is made that the court's charge implies that Benn Myzel had actual knowledge of the specific misrepresented or nondisclosed financial figures, e.g., the interim financial statement of April 30, 1953. This contention is based on a misreading of the instruction. The court simply charged that Myzel had "a duty to disclose *known* facts . . . " leaving to the jury determination whether or not

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[14] Counsel for the Levines stated in his closing argument:

> "Zelman confided in Benn on business matters affecting the company, and Benn became . . . the confidant of Zelman Levine in business matters. . . .
>
> "Zelman relied upon Benn's advice in company matters. They were first cousins. They were personal friends. They were business friends."

Myzel's knowledge encompassed any of the particular facts that would be material to the appellees.

V. DAMAGES. Plaintiffs prayed for alternative relief of either recision or money damages. Upon a motion by defendants to have plaintiffs elect remedies,[15] the district

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[15] Whereas, in federal diversity cases, although the doctrine of election of remedies is considered procedural, if choice of remedies affects the outcome of the litigation it has been held that state law controls. See *Berger* v. *State Farm Mutual Auto Ins. Co.*, 291 F.2d 666 (10 Cir. 1961). However, in actions premised upon a federal right, federal law is controlling. *J. I. Case Co.* v. *Borak*, 377 U.S. 426 (1964). Rule 8 of the Fed. R. Civ. P. allows pleading "relief in the alternative or of several different types . . ." and "separate claims . . . regardless of consistency and whether based on legal, equitable, or maritime grounds."

But the pragmatic concept of federal pleading does not abandon the doctrine of election of remedies altogether. When it becomes prejudicial to the defendant to allow plaintiff to pursue inconsistent forms of relief, the doctrine is still applied. *Nakdimen* v. *Baker*, 100 F.2d 195, 196-97 (8 Cir. 1938); *Abdallah* v. *Abdallah*, 359 F.2d 170, 175 (3 Cir. 1966).

During the trial appellees urged that although they sought recision of the contract they were not required to make an election. The rule followed in both federal and state proceedings is that a party upon notice of the grounds of recision must immediately elect to affirm or deny the contract. *Estate Counseling Service, Inc.* v. *Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 303 F.2d 527 (10 Cir. 1962); see also *Albert* v. *Kopplin Molding Corp.*, 247 F.2d 107 (8 Cir. 1957); Annot., 1 A.L.R.2d 1084, 1085 (1948). There are practical reasons why he should not be able to do both. The logic of this rule is particularly compelling when the property in dispute consists of stocks or fungibles of fluctuating value. A party could otherwise sit back without notification to the wrongdoer and, within the allowable period to sue, watch the market go up or down, thereby speculating on the success or value at the total risk of the wrongdoer. If the market went up, he would ultimately rescind at the time of the trial and seek the stock or its equivalent high value. If the market went down, he would later choose to affirm and sue for its higher value under a theory of tortious conversion. Although the law does not favor a wrongdoer, neither does it promote speculative damages at his expense.

Yet, such election is based upon an equitable choice, and is not so harsh as to prevent a party from later asserting an alternative inconsistent ground, where under mistake of fact or law, the elected theory is no longer available. See *Inland Waterways Corp.* v. *Doyle*, 204 F.2d 874 (8 Cir. 1953); cf. *Friederichsen* v. *Renard*, 247 U. S. 207 (1918).

court ruled that the actions for recision or money damages were not inconsistent, since defendants admitted having disposed of the LPE stock involved, making its return impossible. The trial court treated the action as one at law for money damages. In their complaint and throughout the trial, the plaintiffs insisted upon their right of trial by jury, and the court, relying upon *Dairy Queen, Inc.* v. *Wood,* 369 U.S. 469 (1962), and *Beacon Theatres, Inc.* v. *Westover,* 359 U.S. 500 (1959), properly refused to strike the case from the jury docket. See *Halladay* v. *Verschoor,* No. 18,491 (8 Cir. Aug. 16, 1967); cf. also *Richland* v. *Crandall,* 259 F.Supp. 274 (S.D.N.Y. 1966).

The problem encountered on the damage question which bothered appellants' trial counsel, and which is again raised on appeal, was how recision and recisional damages could be determined by a jury,[16] when the remedy of recision is available solely in an equitable action. *Black* v. *Boyd,* 248 F.2d 156 (6 Cir. 1957); *Union Pac. R. R. Co.* v. *Syas,* 246 F. 561 (8 Cir. 1917); *Wilhelm* v. *Consolidated Oil Corp.,* 84 F.2d 739 (10 Cir. 1936); see McClintock, Equity §84 (2d ed. 1948). Appellees urge in reply that law and equity are fused under modern federal practice (Fed. R. Civ. P. 2) and, therefore, they have the right to disaffirm the contract and still seek damages at law. However, although legal and equitable causes have lost their procedural distinctions, and may now be joined in one action,

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[16] See *Sylvania Indus. Corp.* v. *Lilienfeld's Estate,* 132 F.2d 887 (2 Cir. 1943), holding that an action for "recision" and one for "money damages" were inconsistent. However, treating "money damages" in the case before us as recisional damages (since the stock was nonexistent), it is easy to reconcile the statement of Judge Nordbye, who ruled on the pretrial motion to elect, that the two prayers are not inconsistent.

the substantive and remedial distinctions still properly persist. See *Estate Counseling Service, Inc.* v. *Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 303 F.2d 527 (10 Cir. 1962); *Bradley* v. *United States*, 214 F.2d 5, 7 (5 Cir. 1954); *Bereslavsky* v. *Kloeb*, 162 F.2d 862, 863 (6 Cir. 1947); McClintock, supra, §20, 2 Moore, Fed. Pract. ¶2.02 (1966). See also *SEC* v. *Capital Gains Research Bur., Inc.*, 375 U.S. 180 at 193. The nature of the relief sought, not the statute which creates the right, determines the legal or equitable remedy. *Straley* v. *Universal Uranium & Milling Corp.*, 289 F.2d 370, 373 (9 Cir. 1961). Thus, a jury still cannot rescind a bargain, and without recision accomplished, the bargain stands in the way of restitution. But in an action at law a jury may award recisional *damages* if the contract has already been mutually rescinded or is otherwise set aside by law. See, e.g., *Lydle* v. *Scott*, 157 F. Supp. 729 (N.D. Ohio 1957); Annot., 95 A.L.R. 1000 (1935); see also *Schaefer* v. *Telex, Inc.*, 132 F. Supp. 140 (D.Minn. 1955). Here, neither the jury nor the court was required to rescind the agreement, Section 29(b) of the statute itself declares the sale void, once there is found a violation of Rule 10b-5. 15 U.S.C. §78cc(b); cf. *Goodell* v. *Accumulative Income Corp.*, 185 Minn. 213, 240 N.W. 534 (1932). If the contract was void as a matter of law, the plaintiff was entitled to restitution of what he sold, or, since restoration of the stock was here impossible, an equivalent money judgment. The law is well settled that "where an action is simply for the recovery and possession of specific real or personal property, or for the recovery of a money judgment, the action is one at law." *Whitehead* v. *Shattuck*, 138 U.S. 146, 151 (1891); 3 Loss 1851.

See *Halladay* v. *Verschoor*, supra; cf. *Blazer* v. *Black*, 196 F.2d 139 (10 Cir. 1952).[17]

Appellants also argue that they were entitled to the equitable defense of laches, an issue upon which neither the judge nor the jury passed. However, the doctrine of laches is not applicable where the action was properly tried at law to a jury. See *Straley* v. *Universal Uranium & Milling Corp.*, 289 F.2d 370 (9 Cir. 1961). The applicable measure of the timeliness of the suit was the Minnesota statute of limitations, and the trial judge correctly instructed on that basis. See *Holmberg* v. *Armbrecht*, 327 U.S. 392, 395 (1946), wherein it is said:

> "As to actions at law, the silence of Congress has been interpreted to mean that it is federal policy to adopt the local law of limitation."

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[17] Appellant relies on Judge Cardozo's statement in *Falk* v. *Hoffman*, 233 N.Y. 199, 201, 135 N.E. 243:

> "*Suing at law*, the plaintiff would be restricted to *the value* of his shares, if he rescinded (*Rothschild* v. *Mack*, 115 N.Y. 1, 8), or to *the difference between the value and par* (*the amount paid* to him by the defendants), if he affirmed (*Reno* v. *Bull*, 226 N.Y. 546). *Suing in equity*, he may reach *the proceeds of the resale*, securities and cash, though the price upon resale is found to be greater than the value. . . ."

The *Rothschild* case actually refutes appellants' position that recisional damages can only be obtained in equity. It involves the common law theory of waiving the tort and suing in assumpsit *at law*. This approach blends into the concept of electing to affirm the contract, suing for damages thereon, or disaffirming it and seeking recisional value. As we have previously discussed, such an election is still recognized [see also Mr. Justice Black's dissent in *Prima Paint Corp.* v. *Flood & Conklin Mfg. Co.*, 35 L.W. 4575 at 4580 (1967)], although in modern federal pleading we do not concern ourselves with forms of action. Fed. R. Civ. P. 2.

The reason equitable powers of the court are sometimes needed, is, as illustrated in *Falk* v. *Hoffman*, the desire to trace or reach the proceeds, consisting of *other* securities as well as cash, obtained upon resale of plaintiff's stock. Such equitable relief could not have been obtained by a money judgment alone.

The fact that plaintiffs' original prayer was for recision or for damages in the alternative would not change the applicability of the state limitations statute as opposed to laches. See *Cope* v. *Anderson,* 331 U.S. 461, 463-64 (1947); *Lydle* v. *Scott,* 157 F.Supp. 729; 3 Loss 1772-73.

Recision calls for cancellation of the bargain, and the return of the parties to the *status quo ante;* where this is impossible because of the disposal or retirement of the stock, then equivalent value of the stock at the time of resale (cf. *In re Liebig,* 255 F. 458 (1918) or *at the time of judgment* (cf. *Strong* v. *Repide,* supra, 213 U.S. at 421-22), should be the proper measure of damage.[18]

But where there exists no market value of the stock, the stock is no longer in existence, and there clearly has been a fluctuation in value since the time of the original sale, then what restitutional damages are to be awarded must depend upon the facts of the particular case. As stated in the Restatement of Restitution §151:

> "Where a person is entitled to a money judgment against another because by fraud, duress or other consciously tortious conduct the other has acquired, retained or disposed of his property, the measure of recovery for the benefit received by the other is the value of the property at the time of its improper acqui-

[18] See *Barnes* v. *Eastern & Western Lumber Co.,* 287 P.2d 929, for an interesting parallel situation involving the kind of relief available under similar circumstances. The Supreme Court of Oregon refused to recognize plaintiff's claim of recision since the corporation in which the stock was involved had been dissolved. The court held under such circumstances recision was impossible. The court affirmed a restitutional basis of recovery on quasi-contractual principles, although recognizing that the action was not one at law for money damages, without consideration that recisional damages might be awarded as the equivalent of the return in specie of the stock.

sition, retention or disposition, or a higher value if this is required to avoid injustice where the property has fluctuated in value or additions have been made to it."[19]

See also Restatement of Restitution §65 and illustrations 17 and 18.

The Levines converted each share of LPE into 1,000 shares of Lakeside Industries, Inc. (LII) in 1961. The market *price* of LII was $9 per share when originally issued for public sale in 1962. If the highest restitutional damage had been allowed on the basis of market price at the time of the notice of the conversion, Vertelney's verdict could have been $900,000; Cohen's verdict, $450,000; and King and Fields could have recovered $270,000 each. The book value of LII stock at the time of public sale in 1962 was, according to appellants' evidence, $1.53 per share. The actual value found by the jury for damages shows that Vertelney received $2.12 per share of LII; Cohen, $2,125 per share of LII; Fields, $2,266 of LII per share; and

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[19] Restatement of Restitution § 151, comment c:

"Where the subject matter is of fluctuating value, and where the person deprived of it might have secured a higher amount for it had he not been so deprived, justice to him may require that the measure of recovery be more than the value at the time of deprivation. This is true where the recipient knowingly deprived the owner of his property or where a fiduciary in violation of his duty used the property of the beneficiary for his own benefit. In such cases the person deprived is entitled to be put in substantially the position in which he would have been had there not been the deprivation, and this may result in granting to him an amount equal to the highest value reached by the subject matter within a reasonable time after the tortious conduct. *This is done if he can prove that he probably would have made a sale while the subject matter was at its highest point in value.*" (Our emphasis)

King, $1,533 per share of LII. We refuse to speculate on the reasons for the variances in the valuations awarded. Approximation is all that is necessary. *Palmer* v. *Connecticut Ry. & Lighting Co.*, 311 U.S. 544 (1941); see also *American Fire Apparatus Co.* v. *NLRB* (No. 18,583, 8 Cir. July 26, 1967). Since the awards are well within the provable damages possible we cannot agree with appellants' contention of excessive damages.

Appellants claimed at trial that appellees had positively elected to affirm the contract by seeking a jury trial and thereby had limited their recovery to damages at law based upon the "out of pocket" measure governing actions for tortious deceit. As we have observed, this supposition was not correct. Nevertheless, the trial court informed counsel that since the stock could not be returned he was treating the action as one for money damages.[20] We think it is clear that the court disregarded appellees' claim for recisional damages and instructed the jury in terms of tort damages as applicable to property of undetermined, fluctuating value.

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[20] The court indicated to counsel that his instruction:

"... won't be the usual tort rule, because it will not be the out-of-pocket rule, and it will not be limited to the time of the sale. In other words, I'm going to tell the jury, I think, that they may consider all the evidence as to damages which follows the date of sale. They may consider that in determining value.

"Now maybe this is going to get close to a rescissional measure of damages, but I'm not going to put it in those terms. Now I may to some extent be going beyond a reasonable time, too. But I have in mind going beyond the usual damage instruction where we talk about damages must be determined to a reasonable certainty even though they can't be determined to an absolute certainty. They can reject speculation and conjecture. *And the usual instruction, too that they can assess damages which are the natural, direct, and proximate result of the alleged wrong.*" (Our emphasis)

The court's instructions effectively (for the facts at hand) combine forms of recovery, which are encompassed in several possible legal theories: deceit, conversion by fraud, money had and received and unjust enrichment (quasi-contractual obligation lying in assumpsit at common law.)[21] Yet the court instructed upon the tort concept that to be recoverable the damages must be proximately caused by the defendants.[22]

The court told the jury[23] (1) that the least amount that

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[21] An essential difference is to be found in all the theories in common law actions involving fraud. The problem generally faced is whether the awarded relief should be joint and several or several only. Cf. *Barnes* v. *Eastern & Western Lumber Co.*, 287 P.2d 929, 948, 956 (Ore. 1955). Thus an action for money had and received or for unjust enrichment differs at common law from tortious conversion primarily on the basis that all the defendants may be held jointly liable in tort, while only those who have benefited are liable, and then only to the extent thereof, in an action for unjust enrichment. Restatement of Restitution §5, comments (a) and (b) (1937). But, in the present case this distinction cannot be considered prejudicial for several reasons, most important of which is that the appellants insisted at the trial on treating the action as one for tortious damages, which involves joint and several liabilities regardless of benefit gained.

[22] Although recision is sought as relief, it has been properly observed that an action under Rule 10b-5 lies in tort and not on contractual grounds. *Crist* v. *United Underwriters, Ltd.*, 343 F.2d 902 (10 Cir. 1965). Yet some commentators suggest that if recision alone is sought, problems of "privity" may still apply. See Painter, Inside Information: Growing Pains for the Development of Federal Corporation Law. Under Rule 10b-5, 65 Colum. L. Rev. 1361, 1376 n. 56 (1965). See excellent discussion concerning problems in recision in Rule 10b-5 cases in Comment, Private Remedies Available Under Rule 10b-5, 20 Sw. L. J. 620, 625-26 (1966).

[23] Instruction reads:

> "The general rule of damages is that the seller of stock is entitled to recover the difference between the actual value of the stock at the time it is sold and the price the seller, or plaintiff or plaintiffs here, sold the stock for. The actual value of the stock at the time it is sold is not necessarily determined by

could be recovered would be "the difference between the

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its value at the time of the sale, but may be determined in the light of all the circumstances, including the subsequent history of Lakeside Plastics & Engraving Company.

"If a plaintiff is entitled to damages, he is entitled to recover all the damages which the defendants' conduct has actually caused him.

"As I have suggested, the least amount to which a plaintiff may be entitled is the difference between the selling price of the stock and the actual value of the stock when sold. I have suggested also that you may consider the subsequent history of the company in determining this actual value.

"In determining whether the plaintiffs are entitled to any greater amount, you must decide what the plaintiffs would have done with their stock if there had been no misconduct on the part of the defendants. That is, you must determine the extent to which the defendants' conduct can be said to have been the proximate cause of plaintiffs' claimed losses.

"If you believe that upon full disclosure the plaintiffs, or any of them, would merely have sold their stock at a higher price, then the measure of their damages is the difference between what they received and the higher price.

"In determining what would have happened, you should consider whether the defendants would have paid a higher price, what the future outlook of the business really looked like to an investor at that time or within a reasonable time thereafter, and whether the plaintiffs had any investment opportunities which they thought might be more profitable.

"In other words, you must determine whether, if the claimed misrepresentations had not been made, the plaintiffs would have retained their stock to share in the possible future growth of the company.

"If you believe that the net result of full disclosure would have been that a plaintiff would have retained his stock as an investment rather than selling it to defendants at a higher price, you should consider the subsequent increases in the value of the stock over what you consider a reasonable period as part of the losses of a plaintiff which he is entitled to recover.

"What constitutes a reasonable period is for you to determine upon all the facts of this case. You should bear in mind that the statute is not intended to provide investors with an insurance policy against market changes. It does, however, seek to prevent those who have engaged in fraudulent or illegal conduct from benefiting by that conduct."

selling price of the stock and the actual value of the stock when sold." This, of course, is similar to the traditional "out of pocket" theory of damages recoverable for deceit. A party may seek this as his measure of damage rather than rescind where the stock has depreciated in value or the wrongdoer has later sold the stock at a loss. See 3 Loss 1793. Since the stock increased rather than decreased in value, this measure of damage was actually contra to appellees' interest in full restitution. We fail to see any prejudice to appellants under this part of the instruction. (2) A higher amount could be recovered if the jury found that upon full disclosure the plaintiffs would nevertheless have sold to defendants, but at a higher price. Then the measure of the damages would be the difference between what they actually received and the higher price. (3) And finally, if the jury found that the plaintiffs, upon a complete disclosure, would have retained the stock, then the jury could consider "the subsequent increases in the value of the stock over . . . a reasonable period."

Appellants' specific exceptions at the time of the trial were directed to the court's allowing the jury to determine the actual value at the time of sale by considering the subsequent history of the company for a reasonable time after the sale. Appellants argued that the court had failed to state any limitation as to what "a reasonable time" period included, and further urged that there was no evidence of any events occurring after the sale which would have a bearing on the value at the time of the sale.

The "out of pocket" theory is the measure of damages early adopted in pre-Erie federal cases involving fraud and deceit. See, e.g., *Smith* v. *Bolles*, 132 U.S. 125 (1889);

Sigafus v. *Porter*, 179 U.S. 116 (1900); *Towle* v. *Maxwell Motor Sales Corp.*, 26 F.2d 209 (8 Cir. 1928). However, where fungibles such as corporate stock have no ready market value and actually fluctuate in value, different measures or modified versions of the same theory become more appropriate. *Galigher* v. *Jones*, 129 U.S. 193, 200 (1889); *In re Salmon Weed & Co.*, 53 F.2d 335, 340-43 (2 Cir. 1931). As stated in *Hawkins* v. *Mellis Pirie & Co.*, 127 Minn. 393, 149 N.W. 663, 664 (1914):

> "When stock in a corporation has not figured in the markets, and there have been no sales or dealings therein, its actual value must be determined at the fair price which a person who desires to buy would be willing to pay, taking into consideration the original capital, how far there has been profit or loss in the business carried on, the assets and liabilities, the future prospects, and everything that goes to affect the value of the shares of stock."[24]

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[24] See O'Neale & Derwin, op. cit. §2.16 at 35, where the problem of valuation of an interest in a closed corporation is appraised. As part of the damage instruction, the trial judge told the jury:

> "The company stock was until the spring of 1962 closely held by a limited number of individuals. The stock was not traded publicly and there seems to have been no market for it prior to the spring of 1962 over-the-counter or otherwise.
>
> "In determining the actual value of stock which is not traded publicly, there are a number of factors for you to consider. You may consider, among other factors, the following:
>
> "1. The current net worth or book value of the stock per share at the time of the sale and for a reasonable time thereafter.
>
> "2. The past and current record of growth or lack of growth of sales, net worth and earnings. Have the company's sales, net worth and earnings been increasing over the years or has the company been in continual financial difficulty.
>
> "3. The prospects of the company for a reasonable time in the future from the time of the sale of the stock of increased sales and net worth and earnings.

Actually, damage for tortious conversion by deceit provides a comparable legal remedy. *Rochrich* v. *Holt Motor Co.*, 201 Minn. 586, 277 N.W. 274 (1938); *Holland* v. *Bishop*, 60 Minn. 23, 61 N.W. 681 (1895); *In re Franklin Saving & Loan Co.*, 34 F.Supp. 585 (E.D.Tenn. 1940); Annot., 95 A.L.R. 615 (1935); 89 C.J.S., Trover & Conversion §41. Cf. *Nephi Processing Plant, Inc.* v. *Talbott*, 247 F.2d 771 (10 Cir. 1957). The federal courts have historically approved a rule of damages for conversion of stock measured by the price at the time of conversion or the highest intermediate value reached within a reasonable time after notice of the conversion by the plaintiff,[25] whichever is greater. In

"4. The past dividend record and the prospects for dividends for a reasonable time in the future from the time of the sale of the stock.

"5. The particular products which the company manufactured or sold at the time of the sale and for a reasonable time thereafter.

"6. The nature of the competition which the company had in the market at the time of sale and for a reasonable time thereafter.

"7. The skill of the management at the time of the sale of the stock, and for a reasonable time thereafter.

In weighing these factors, you should consider the purposes for which the stock might be purchased or retained by a plaintiff as an investor."

[25] In cases where defendant is plaintiff's broker or agent, different considerations may arise. In *McKinley* v. *Williams*, 74 F. 94 (8 Cir. 1896), this court held the proper measure of damages to be the highest value which stock has reached between the date of conversion and reasonable time after notice of it, even though the higher value was reached before notice. This rule is criticized in *In re Salmon Weed & Co.*, 53 F.2d 335 (2 Cir. 1931), in which recovery was limited to the value at the time of the conversion or the highest intermediate value reached between the time of notice of the conversion and a reasonable time after notice. See also *Satterwhite* v. *Harriman Nat'l Bank & Trust Co.*, 13 F.Supp. 493 (S.D.N.Y. 1935); 11 Fletcher, Cycl. Corp. §5117 (1958).

Galigher v. *Jones,* supra, 129 U.S. at 200, the Supreme Court said:

> "Other goods wrongfully converted are generally supposed to have a fixed market value at which they can be replaced at any time; and hence, with regard to them, the ordinary measure of damages is their value at the time of conversion, or, in case of sale and purchase, at the time fixed for their delivery. *But the application of this rule to stocks would, as before said, be very inadequate and unjust.*" (Our emphasis)

In *SEC* v. *Capital Gains Research Bur., Inc.,* 375 U.S. 180, 194 (1963), the Court commented:

> "There has also been a growing recognition by common-law courts that the doctrines of fraud and deceit which developed around transactions involving land and other tangible items of wealth are ill-suited to the sale of such intangibles as advice and securities, and that, accordingly, the doctrines must be adopted to the merchandise in issue."

In *Janigan* v. *Taylor,* 344 F.2d 781 (1 Cir. 1965), the Court of Appeals for the First Circuit faced a similar problem of damages where the seller of securities was the party defrauded. As Chief Judge Aldrich realistically points out, in such an instance justice required that the "out of pocket" theory reflect future accretions.[26] Cf.

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[26] See Restatement of Restitution §151, illustration 3, where it is stated:

> "By fraud as to his financial condition, A purchases shares from B on January first, the market value of the shares being $3000 which A promises to pay. A week later the shares rise to $4000 at which time B would have sold them if A had not bought them. They then drop back to $3500, when B discovers the fraud and demands restitution. B is entitled to receive $4000 from A."

Staker v. *Reese*, 82 W.Va. 764, 97 S.E. 641, 646. But appellants urge the *Janigan* rule has its limitations, where the wrongdoer himself creatively contributes to the value of the property, such as an artist who paints a valuable picture with wrongfully acquired paints. However, such factors are not any more present here than in *Janigan*. As in the latter case, the appellants all functioned as directors and salaried officers of their respective corporations in building up the business of LPE. It is argued that "extraordinary contributions" were made by the Levines, such as their personal guaranties on bank loans for working capital and their introduction of new lines of business. But these are not totally unforeseeable in the growth of a closely held corporation. But foreseeable or not, as stated by the court in the *Janigan* case:

> "[I]f the property is not brought from, but sold to the fraudulent party, future accretions not foreseeable at the time of the transfer even on the true facts, and hence speculative, are subject to another factor, viz., that they accrued to the fraudulent party. It may, as in the case at bar, be entirely speculative whether, had plaintiffs not sold, the series of fortunate occurrences would have happened in the same way, and to their same profit. However, there can be no speculation but that the defendant actually made the profit and, once it is found that he acquired the property by fraud, that the profit was the proximate consequence of the fraud, whether foreseeable or not. It is more appropriate to give the defrauded party the benefit even of windfalls than to let the fraudulent party keep them." 344 F.2d at 786.

It is also argued by appellants that the *Janigan* theory is solely an equitable remedy for accounting[27] similar to the theory of constructive trusts. Cf. *Marcus* v. *Otis*, 168 F.2d 649 (2 Cir. 1948). The objection raised is that "conscious wrongdoing" must be involved and that none exists here. Appellants contend, therefore, that damages for innocent nondisclosure do not extend to accretional value but only to "out of pocket" losses. The same argument can traditionally apply to cases of innocent conversion. See Restatement of Restitution §§154, 155, 203.

But there exists no apparent reason to apply different rules of damage to different violations under the Act. The act of nondisclosure is the evil proscribed, not the motive that induced it. Appellants' argument fails to consider that the common law concept of fraud under the security laws has now been enlarged under Rule 10b-5 to include even innocent nondisclosures which may amount to manipulative or deceptive conduct. See *Ellis* v. *Carter*, 291 F.2d 270 (9 Cir. 1961); *Dale* v. *Rosenfeld*, 229 F.2d 855 (2 Cir. 1956); compare *SEC* v. *Capital Gains Research Bur., Inc.*, 375 U.S. 180, 200 (1963). Such conduct is prohibited within the definition of Rule 10b-5. The violation of the rule connotes "unfairness" or "wrongdoing." And as the Supreme Court said in *SEC* v. *Capital Gains Research Bur., Inc.*, supra, 375 U.S. at 195:

> "Congress intended the investment Advisers Act of 1940 to be construed *like other securities legislation* 'enacted for the purpose of avoiding frauds,' not

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[27] Even an action for accounting can state a legal cause for legal damages and a jury. See *Beacon Theatres, Inc.* v. *Westover*, 359 U.S. 500 (1959).

> technically and restrictively, but flexibly to effectuate its remedial purposes." (Our emphasis)

However such arguments may run, they are to no avail here. We have previously observed in discussing "scienter" that the trial court required the jury to find that the "manipulative or deceptive" conduct consisting of misrepresentation or nondisclosures under Rule 10b-5 be done with the "intent of inducing" the sale. This sufficiently refutes appellants' contention that there was no finding of "conscious wrongdoing."

Complaint was made of the trial court's cautionary instruction directing the jury not to consider the financial condition of LPS unless the relationship of LPS and LPE was found to bear upon the determination of the value of the LPE stock. Consideration of (1) the total business interdependence of the two companies, (2) the valid inference of participation in the fraud by LPS and its alter egos, William and Orrin Levine, (3) the use of LPS as a conduit of the fraudulent drive for total ownership, (4) the use of LPE funds to pay Benn Myzel for LPE stock transferred to LPS, (5) the exclusive sales arrangement between LPE and LPS and (6) the utlimate "gratuitous" division of LPS and LPE among the Levines, demonstrates that the companies could have sufficient "relationship" to one another to affect value of the LPE stock not only in 1953 but in subsequent years as well. And although we are dealing with an instruction, appropriate is our observation that relevancy of evidence is a matter upon which the discretion of the trial judge will remain undisturbed absent clear finding of abuse. *Frohmann* v. *United States*

(No. 18,576, 8 Cir. July 27, 1967); *Cotton* v. *United States*, 361 F.2d 673 (8 Cir. 1966).

Appellants final attack on the damage instruction urges that the Securities Exchange Act, §28(a), 15 U.S.C. §78bb (a), provides and also limits recovery to "actual damages" as follows:

> "[N]o person permitted to maintain a suit for damages under the provisions of this chapter shall recover . . . a total amount in excess of his actual damages on account of the act complained of."

However, we feel the only effect of this provision is to prohibit punitive damages, which otherwise might be available in some states in civil actions under the Securities Exchange Act of 1934. See 3 Loss 1624; see also, *Pappas* v. *Moss*, 257 F.Supp. 345 (D.N.J. 1966); *Meisel* v. *North Jersey Trust Co.*, 216 F.Supp. 469 (S.D.N.Y. 1963); *Mills* v. *Sarjem Corp.*, 133 F.Supp. 753, 770 (D.N.J. 1955). Express civil relief is not provided under Section 10(b) or Rule 10b-5, notwithstanding the long existence of section 28(a).[28] Nevertheless federal law provides a remedy. Cf. *J. I. Case Co.* v. *Borak*, 377 U.S. 426 (1964). In *Kohler* v. *Kohler Co.*, 208 F.Supp. 808, 825 (E.D.Wis. 1962), aff'd 319 F.2d 634 (7 Cir. 1963) (relying upon "buyer" cases); and *Estate Counseling Service, Inc.* v. *Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 303 F.2d 527, 533 (10 Cir. 1962) (a "buyer" case) it was stated that the term "actual

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[28] One early issue faced by the courts was whether the Securities Exchange Act of 1934 provided *any* civil remedy at all for violation of Section 10(b). See *Kardon* v. *National Gypsum Co.*, 73 F.Supp. 798, 802 (E.D.Pa. 1947); see also *Greater Iowa Corp.* v. *McLendon*, 378 F.2d 783, 791 (8 Cir. 1967).

damages" limits recovery to the "out of pocket" measure. We feel that the philosophy of *Janigan* v. *Taylor,* supra, 344 F.2d at 786-87, is more suitable as reflecting an approach to damages involving defrauded sellers and in no way violative of Section 28(a). It is not "punitive" to award a plaintiff the equivalent value of his stock, where the jury finds that with full disclosure he would have retained it until the higher price gained by the wrongdoer was reached. This is "the antithesis of punishment." Compare *Sunbeam Corp.* v. *Golden Rule Appliance Co.,* 252 F.2d 467 (2 Cir. 1958). See *Speed* v. *Transamerica Corp.,* 135 F.Supp. 176, 186-94 (D.Del. 1955), modified on other grounds, 235 F.2d 369 (3 Cir. 1956).

Although the trial court fashioned and submitted to the jury a remedy for the particular facts, we fail to see any prejudice to appellants. The damages given essentially reflect a proper measure of damages for deceit based upon an unknown fluctuating value of stock of a closed corporation *under the particular circumstances surrounding the case.* The trial court was faced with great difficulty in instructing upon these issues and did an excellent job. His approach on instructions was fair to the appellants under the circumstances prevailing.

VI. THE SUCCESSOR CORPORATION. In December 1961 the four Levines transferred all their holdings of LPS stock to LPE. Lakeside Properties, Inc. (LPI), a subsidiary of LPS, transferred the 640 shares of LPE stock to LPE at the time LPI was merged with LPE. The merged company was renamed Lakeside Industries, Inc., a Minnesota corporation, and subsequently a new Delaware corporation of the same name, Lakeside Industries,

Inc., became the successor of the merged company. It was at this time that the Levines exchanged their 500 shares of the merged corporation's stock for 500,000 shares of common stock of LII, the currently existing Delaware corporation.

Appellants urge that the newly organized corporation is not liable as a successor corporation, since (1) LPE did not itself receive anything of value in the stock exchanges, (2) if any fraud existed, the corporation itself was a victim, since corporate funds were used in purchasing the corporation's stock for the officer's own benefit, and (3) to impose liability on the new corporation would prejudice the rights of bona fide public stockholders.

The corporation laws of Minnesota provide:

> "Liabilities not affected. The liabilities of the constituent corporations or of their shareholders, directors, or officers, shall not be affected nor shall the rights of creditors or of any persons dealing with such corporations be impaired by the consolidation or merger, and any claim existing or action or proceeding pending by or against any of such constituent corporations may be prosecuted to judgment as if such consolidation or merger had not taken place, or the consolidated or surviving corporation may be proceeded against or substituted in its place." M.S.A. §301.45(1) (1945).

The fact that bona fide public stockholders might indirectly be prejudiced by the corporation's payment of indebtedness incurred by a predecessor corporation is not persuasive. Stockholders are presumed to invest with knowledge of proper corporate liabilities. If any harm

exists by reason of the corporation's legal liabilities wrongfully caused by its officers or directors, such damage can be corrected through proper proceedings.

Appellees posited their case upon a "plan" by appellants to get sole control of LPE by 100% ownership of stock. The jury accepted this theory of the case. In so doing, it considered evidence that LPS acquired part of the stock with monies paid by LPE. LPS carried the stock as assets. LPE eventually gained possession of its own stock and upon the vote of the only other holders of stock, the Levines, this stock was retired. It is well settled that acts of managing officers or directors constitute "business . . . of the corporation, though unauthorized by its charter." See Ballantine, Corporations §111 at 273 (Rev.ed. 1946). Thus, any deceit practiced by the corporation's officers or agents acting on behalf of the corporation, ever though ultra vires, binds the corporation. See *Brennan* v. *Midwestern United Life Ins. Co.*, 259 F.Supp. 673, 681 (N.D. Ind. 1966).

And, in an action for tortious damage, the fact that LPE retired the treasury shares rather than selling them is immaterial. It has long been held that a party is responsible for tortious wrongdoing though, as perpetrator thereof, he realized no benefit from it. See *James-Dickinson Farm Mtg. Co.* v. *Harry*, 273 U.S. 119, 123 (1926). The same rule has been upheld in Rule 10b-5 cases. See e.g., *Fischer* v. *Kletz*, 266 F.Supp. 180, 187-88 (S.D.N.Y. 1967).

VII. GOLDFINE AND ROSE TRANSACTIONS. Objection is made as to the relevancy of Zelman Levine's purchase, through Benn Myzel, of Ida Goldfine's stock and LPS's acquisition, again through Benn, of Maurice Rose's

stock. We have examined these transactions and find that they could be relevant to the entire picture involved. The admitted *undisclosed* control of Myzel by Zelma Levine in dealing with the Goldfine stock could properly aid in weighing the credibility of the Levines' denial of control of Myzel in dealing with appellees. The jury disbelieved that denial. The Goldfine and Rose transactions give credible support to the accepted inference of *undisclosed* control throughout all the transactions. The evidence again is well confined within the discretionary finding of relevancy by the trial judge. *Frohmann* v. *United States* (No. 18,576, 8 Cir. July 27, 1967).

Many of the questions presented upon this appeal turned upon the sufficiency of the evidence to support the verdict. Appellees, therefore, submitted a supplemental printed record consisting of 583 pages. Appellees also moved for a dismissal of the appeal or at least that the scope of review be limited because of the alleged inadequacy of the appellants' printed record. Cf. *Sublette* v. *Servel, Inc.*, 124 F.2d 516 (8 Cir. 1942). However, very little of the supplemental record was of help to the court in deciding the case. Under the circumstances our rules (Eighth Circuit Rule 10(c)) provide a means to amend or supplement the record *when necessary*. Cooperation of counsel in this regard should not be a problem. We feel counsel for appellants were in good faith in preparation of the original record. The great majority of the supplemental record is superfluous and violative of our Rule 10(c). Under the circumstances, we hold that appellees' costs for preparation of the supplemental record should not be taxed against

the appellants. See *Milwaukee Ins. Co.* v. *Kogen*, 240 F.2d 613, 618 n. 2 (8 Cir. 1957).

Judgments affirmed.

A true copy.

Attest:

Clerk, U. S. Court of Appeals, Eighth Circuit.

Order of United States District Court

Order

(Filed Oct. 28, 1964)

These actions are before the Court on motion by the defendants for an order striking the cases from the jury calendar and placing them on the court calendar.

Mr. Robert J. King, of Messrs. Hvass, Weisman and King, Minneapolis, Minnesota, appeared in behalf of defendants Benn Myzel and Philip Myzel, and Mr. Carl Lifson, of Messrs. Lifson and Kelber, Minneapolis, Minnesota, appeared in behalf of the remaining defendants in support of said motion;

and

Mr. Edward M. Glennon, of Messrs, Lindquist, Magnuson and Glennon, Minneapolis, Minnesota, appeared in behalf of the plaintiffs in opposition thereto.

Plaintiffs in this cause are seeking a federal remedy under Section 10 of the Securities and Exchange Act of 1934, 48 Stat. 891 (1934), as amended, 15 U.S.C. Section 78j (1963). Although not specifically mentioned, civil remedies are afforded private parties harmed by violations of the Act. Ellis v. Carter, 291 F. 2d 270, 273-74 (9 Cir. 1961); Slavin v. Germantown Fire Ins. Co., 174 F. 2d 799, 801 (3 Cir. 1949). Moreover, Section 78aa, 15 U.S.C. (1963) grants federal district courts exclusive jurisdiction "of all suits in equity and actions at law brought to enforce any liability or duty created by this chapter or the rules and regulations thereunder."

The complaint alleges that plaintiffs were fraudulently induced to sell to the individual defendants their stock in the defendant corporation, Lakeside Industries, Inc., which stock has allegedly become considerably more valuable since the time of the sale. Each of the plaintiffs state that the "purpose of this action is to recover damages against the Defendants for injuring Plaintiff in his property, which injuries proximately resulted from Defendants' violations of the Securities Exchange Act of 1934." They then allege that, in soliciting and effecting the offers to them by defendants, the latter made statements and representations which were false and misleading and untrue statements of material facts, or they omitted to state or failed to include material facts necessary to make them, in light of the circumstances under which they were made, not misleading, in contravention of the Securities Exchange Act of 1934 and the rules and regulations which the Commission has promulgated thereunder.

After reciting the alleged statements, representations or omissions, the plaintiffs allege that they did not discover the falsity of the statements and representations, or that material facts were omitted, until March 1, 1962, by reason of certain circumstances set forth in the complaints. Plaintiffs contend in their separate complaints, as reflected in Paragraph 13 thereof, that they sold their stock in Lakeside to defendants at various dates in 1953, 1954 and 1956, and that, as a proximate result of defendants' unlawful acts, they have been materially damaged. In the Vertelney case, the damages are alleged to be $1,000,000; in the Fields case, $300,000; in the King case, $300,000; and $400,000 in the Cohen case. These damages are alleged to be the "proximate result of defendants' unlawful acts."

It seems clear that the plaintiffs in the first 13 paragraphs of each complaint have stated an action in law for damages resulting from the alleged violation of the Securities Exchange Act of 1934 as amended. However, in Paragraph 14, which is the last paragraph of the complaint in each case, appears the following:

> "Plaintiff hereby tenders to defendants [here follows the amount that each of the plaintiffs received for his stock] used by them to unlawfully purchase the said stock of Defendant Lakeside from him as set forth herein."

In the prayer for relief, each plaintiff states:

> "WHEREFORE, Plaintiff demands judgment against defendants and each of them as follows:
>
> "(a) For rescission of said sale as alleged in Paragraph 13 hereof, Plaintiff to be put in the same position he would have been had he held said securities until March 1, 1962;
>
> "or in the alternative,
>
> "(b) For judgment against Defendants and each of them for the sum of [$1,000,000 in the Vertelney case; $300,000 in the Fields case; $300,000 in the King case; and $400,000 in the Cohen case]."

Each of the plaintiffs has made a timely demand for a jury trial and these cases are now on the jury calendar for trial. Defendants have moved to strike the actions from the jury calendar and have requested their transfer to the court calendar on the grounds that the action of each plaintiff is one of equity, and therefore a jury trial as a matter

of right is unavailable. They urge that the tender by the plaintiffs of the consideration paid by the defendants to each of the plaintiffs is consistent only with an action for rescission of the sale by a court of equity. In addition, defendants urge that plaintiffs having elected to proceed in equity and having disaffirmed the sale and now seek to obtain a return of their stock, they have committed themselves to this preferred form of relief. In addition, the defendants argue that plaintiffs cannot have cumulative and inconsistent remedies, one bottomed upon a disaffirmance and the other on an affirmance, and having selected equity, it is urged that they are now relegated to the so-called rescission damages in equity if their first request for a restoration of their stock cannot be attained.

But, realistically considered, plaintiffs have not selected inconsistent remedies. They do not seek to disaffirm and then affirm. They have asked for the return of their stock, but the seeking of damages in the alternative would be due to defendants' acts in having made it impossible to obtain the aid of equity. That is, if equity is unable to aid them, and having pleaded an action upon which damages proximately resulting from the violation of the Act may be allowed, there is no inconsistency in asking for such damages in law. Moreover, it appears from the answers on file that the defendants have disposed of the stock that plaintiffs sold to them. Hence, if that is true, it seems clear that the litigation now in its present posture is merely one of law in which the plaintiffs are clearly entitled to a jury. The cases of Dairy Queen, Inc. v. Wood, 369 U. S. 469, and Beacon Theatres, Inc. v. Westover, 359 U. S. 500, fully support the conclusions reached herein and strongly

militate against the cases cited by the defendants as authority for their motion.

It follows, therefore, that the motion of the several defendants to strike these cases from the jury calendar is denied. It is so ordered. An exception is allowed.

Dated this 27th day of October, 1964.

By the Court:

GUNNAR H. NORDBYE,
Judge.

Opinions of the United States District Court

Memorandum

These cases arise under the Securities Exchange Act of 1934. Congress declared it unlawful for any person directly or indirectly to employ in the purchase of a security any manipulative or deceptive device in contravention of any regulations the SEC might prescribe in the public interest or for the protection of investors.

The S.E.C. regulations make it unlawful:

1. To make untrue statements of material facts.

2. To omit to state a material fact necessary to prevent the statements made from being misleading.

3. To fail to disclose a known fact not available to the other party but reasonably known to be important to the other party in determining the value of the stock held by the other party.

The Act of Congress was a remedial statute necessary to protect investors. The language used is broader than the common terms of fraud or misrepresentation. The latter terms are used by lawyers and courts and will be used here.

Congress provided a Federal remedy to defrauded investors. It is the duty of the Federal courts to make effective the rights thus created and provide the necessary remedies to make effective the congressional purpose. J. I. Case Co. v. Borak, 377 U. S. 426 (1964); Janigan v. Taylor, 344 F. 2d 781 (1 Cir. 1965); Speed v. Transamerica Corp., 135 F. Supp. 176 (Del. 1955).

The four plaintiffs charged the defendants specifically with violations of Section 10(b) of the Securities Exchange Act of 1934 and the regulations issued pursuant thereto. The complaints were filed on March 28, 1963, by three of the plaintiffs and on July 11, 1963, by the fourth plaintiff. The defendants denied the allegations. The four actions were consolidated for trial. The trial commenced in Duluth on May 26, 1965, and took parts of four weeks. The jury returned verdicts in varying amounts for each of the plaintiffs. Plaintiff Cohen did not sue defendant Philip Myzel and the jury found for defendant Philip Myzel and against plaintiff King.

Defendants now move for judgments notwithstanding the verdict and, in the alternative, for new trials.

Charges of fraudulent misconduct are not lightly made, and most often are vigorously challenged. The trial generated some heat between the parties and able trial counsel and in the nature of the situation is perhaps to be expected.

LPE had its beginnings in Duluth in 1946. Defendants did not have the necessary capital or, if they did, were not willing to risk all of their assets to finance a new business. Plaintiffs were not the kind of people to invest in untried ventures. Like many other people, however, they perhaps hoped some time to make the kind of investment in a business which might have the kind of growth possibilities many small investors dream about and which many of us read about.

Some plaintiffs knew when they turned their money over to the defendants in 1946 that they were investing in two business ventures. One or more of the plaintiffs did not

have this knowledge. The second business failed in 1947 and the plaintiffs lost this part of their investment.

The fact that plaintiffs made these investments undoubtedly permitted the defendants to stay in business. Plaintiffs' stock purchases represented substantial investments in a new business which at the time of investment had little sales, no profits, and few employees.

During the time plaintiffs held their stock they received no dividends. This is understandable in that if some years do produce profits the income can better be used in the business, and a new and growing business is generally in need of additional funds. It is also true that where a small officer group controls enough stock to provide control the income will be distributed in the form of salaries, etc., in order to produce tax deductions to the corporation.

It is obvious that there came a turning point in the affairs of the defendants in the spring of 1953. This marked the completion of the profitable Blatz contract, the final discharge of substantial financing and relief from burdensome borrowing costs. The defendants could now see daylight and with their knowledge of the business for over six years were in the best position to know its prospects and possibilities. Having this knowledge, the defendants decided to get the stock back into the close family group. This is sometimes done and is not wrongful unless fraud is practiced.

The interim financial statement for the first four months of 1953 showed a profit of about $30,000. This four month profit, considered in the light of previous success or lack of success, was, of course, phenomenal. The jury could infer from this alone that the defendants then decided to embark on their plan or scheme to obtain the stock of plain-

tiffs. Interim statements of this kind are generally available only to officers or substantial stockholders.

The defendants must then determine whom to use to purchase the stock. Zelman Levine tried before September 17, 1953, to purchase the stock of Vertelney, but was unsuccessful. It was logical to use Benn Myzel, the person who had gotten the plaintiffs to make their investments back in 1946, to repurchase the stock. Benn Myzel was not, however, on speaking terms with Fields, so it became necessary for Phil Myzel to make the purchase. And Phil Myzel was a fishing companion of Vertelney and so he made this purchase. Ida Goldfine (not a plaintiff) would not sell to Zelman Levine. Benn Myzel told her that he was buying her stock for himself, which was not true.

The purchases of the stock commenced shortly after May 1953, and continued insofar as these plaintiffs were concerned until March, 1954. Plaintiffs testified to the claimed misrepresentations. Defendants flatly denied making these statements. A most important responsibility for a jury is to judge credibility. The jurors determined the plaintiffs were telling the truth and that defendants were not. The Court could add its own evaluation of the credibility of some of the defendants, but will refrain from doing so.

Defendants claim that the jury verdicts should be set aside in order to prevent a gross miscarriage of justice. Defendants place great emphasis on the fact that LPE had a profit of about $30,000 in the first four months of 1953 and a profit of only $20,000 for the entire year. Defendants then argue that this shows without dispute a net loss of $10,000 for the last eight months of the year 1953. The last

eight month period covers the period of three of the stock purchases, September to December, 1953. The figures in the four month interim statement were tentative and not final. The practice of many companies, assuming the available information indicates a profitable year, is to make any number of year end adjustments to reduce profits and thus reduce income taxes which must be paid in cash. The record indicates that this was done here. Defendants' repeated contention that the last eight months produced a net loss of $10,000 is not in accord with the facts or business practice.

Defendants claim that there was no evidence as to backlogs of orders. These are not generally reflected in financial statements and stockholders are made aware of this fact, if at all, orally by reports at stockholder meetings or on occasion by separate letter to stockholders. Defendants claim that there was little in the way of backlog of orders or prospects in the fall of 1953 to indicate later sales or profits. The successful completion of the substantial Blatz contract and the profits generated thereby would justify increased sales activity and this activity might produce sales at a much later time. This seems to have happened here.

There was, of course, a fair profit in 1952 and the interim statement through April 30, 1953, indicated a substantial profit. Defendants knew these facts, knew the successful completion of the Blatz contract, and knew the prospects for profitable future operations. There is no evidence that plaintiffs were given this information, though defendants argue that some of it might perhaps been made available on request of plaintiff stockholder.

Defendants argue that there was no evidence that the plaintiffs upon full disclosure would have held their stock

beyond the date of sale and, in the alternative, beyond 1957. The fact is, and the jury so found, that misrepresentations of the defendants caused the sales and there is no reason therefore to indulge in the hypothetical situations posed by defendants.

Defendants attack certain of the Court's instructions and the failure to give certain requested instructions.

Defendant Benn Myzel was clearly an insider, and the instruction on this point was correct.

Defendants claim that the instruction regarding a plan or scheme was clearly erroneous. The instruction was proper.

Defendants argue that their requested instruction which would have permitted a finding against the Levines only if plaintiff proved that it was a part of such plan that the stock of a plaintiff be acquired by fraud, should have been given. This is a familiar argument. A somewhat current analogy is the antitrust situation where the company has a strict policy of advising officers and employees not to violate the antitrust laws, and yet the officers and employees conspire to fix prices. The policy of the company is no defense. Defendants' argument seems more directed to the lack of proof of fraud.

Defendants object to the failure to give other requested instructions. The Court refused to give a number of instructions requested by each side. The instructions given stated the applicable law, and this is sufficient. The Court does not agree that the denial of requested instructions to either side was at all prejudicial.

Defendants claim error in the admission and exclusion of evidence at the trial. Certain evidence becomes admissible where a common plan or scheme is alleged. The evidence

supports the inference that the defendants intended and planned to obtain by whatever means possible all of the stock of non-Levine stockholders. Benn Myzel's misrepresentation to Ida Goldfine was highly relevant to a plan or scheme to defraud. The brief reference to the Rose transaction was of little consequence.

The Court refused to permit Benn Myzel to testify to conversations with Phil Myzel. Defendants argue that this is admissible to show Benn's state of mind. The offered testimony is clearly hearsay and not admissible. Benn Myzel testified at great length and what he told Phil Myzel would, moreover, be repetitious.

The newspaper article of September 4, 1959, was hearsay evidence. Much of the article contained an account of statements made to the reporter by Zelman Levine of the reasons for leaving Duluth and moving to Minneapolis. The plaintiffs all indicated that they saw the headlines and some, if not all, stated that they remembered the reference to 250 employees. These two items were the important parts of the article for the defendants. This evidence was received. The article itself would therefore have added nothing.

Defendants claim that plaintiffs' counsel was guilty of pejudicial misconduct. As suggested earlier, fraud cases generate much heat between the parties, and this friction undoubtedly carries over to counsel. A trial of this kind and length develops the usual irritations. A few items objected to should perhaps have been omitted by plaintiffs' counsel. They are, however, of minor significance to the broader issues. One or more of the matters objected to were prompted by evidence adduced by defendants' counsel. The remarks of counsel or questions asked or evidence

adduced which to defendants seem improper were not prejudicial. Defendants in fraud cases yield evidence grudgingly, if at all. Orrin Levine on his first afternoon of testimony was a particularly evasive witness. His testimony the next morning was much more direct. The jury was told whatever was said by counsel was not evidence, and that the jury was to decide the disputed issues of fact from the evidence, and from this alone.

The jury in finding against the defendants could infer that there was a plan or scheme to acquire the stock by any and all available means. The means used have been recounted in part.

The transfer records for some of the stock reflect a contemporaneous transfer to Benn Myzel and from him to LPS. The Levines gradually equalized their holdings of LPE and LPS stock and the jury could perhaps infer that this was part of the scheme.

The Levines approved the payment of commissions to Benn Myzel. Benn Myzel received the initial payment on the Blatz "Commission" in August of 1953 and the remainder of the $4,450 by the end of the year. Three of the stock purchases were made in the period between September to December, 1953. The jury could infer that these were not commissions, the Blatz order having been obtained in 1951 and completed in the spring of 1953. Several defendants testified, as the Court recalls, that the $4,450 was not in fact a commission for the Blatz order, but was in fact payment for something else. The timing and the manner of payment are significant, and the jury could infer that the Levines were paying Benn Myzel to obtain the stock.

The Levines approved the payment of a consultant's fee of $35,000 to Benn Myzel. The jury could infer that this substantial consultant's fee was paid to Benn Myzel for his successful efforts in obtaining the stock. Several defendants testified that this $35,000 was part of the purchase price for the stock. The income tax implications can be left for another day. The obligation of LPE for the $35,000 was assumed by defendant successor corporation Lakeside Industries, Inc., the last payment having been made in 1965.

Payment for the stock in the foregoing manner could well constitute acts of fraudulent concealment. The liberal Federal rule relating to fraudulent concealment tolls the statute of limitations for the period of concealment.

The Court has denied the motions of defendants. The defendants had a fair trial before a competent jury charged with the duty of resolving the disputed fact issues. The parties were represented by able counsel. The multitude of erorrs assigned by defendants' counsel suggest that at least a new trial should be had. The trial, like most trials, is not free of error, but the error, if any, seems to the Court insubstantial and not prejudicial.

Another trial would undoubtedly take a longer time and in this Court's opinion would not produce any substantially different result.

Dated November 19, 1965.

EARL R. LARSON.

Memorandum

Defendants after a complete and thorough trial to a jury now ask the Court to determine whether stock in defendant Lakeside Industries can be returned in kind, whether plaintiffs are barred from obtaining a return of the stock or its money equivalent by reason of laches, and if such relief is obtainable, whether the jury's verdict was advisory only and, if so, whether plaintiffs have proved fraud.

Defendants also ask the Court, if the foregoing be denied, to direct plaintiffs to elect whether to affirm or disaffirm the sales in controversy.

Defendants in their Answers stated that the stock had been disposed of and that there had been substantial corporate reorganizations, indicating thereby that the stock could not be returned. Judge Nordbye reviewed the pleadings and heard arguments, and in his pretrial Order stated that the litigation was merely one of law. This Court treated the litigation as involving primarily legal issues and the jury awarded money damages because under the evidence and instructions it was required to do so if it found for the plaintiffs.

The complaints were based on a Federal Securities Act and the regulations of the S.E.C., and old legal doctrines based on common law fraud theories have lost some of their vitality. Recent decisions of the Supreme Court and other courts in this and other areas of the law indicate as much. J. I. Case Co. v. Borak, 377 U.S. 426 (1964); Janigan v. Taylor, 344 F. 2d 781 (1 Cir. 1965); Speed v. Transamerica Corp., 135 F. Supp. 176 (Del. 1955).

On the issue of discovery of the fraud the Court did submit a proper instruction to the jury. No more was necessary. Nor can this Court now determine whether there was fraud or not. This was the important issue before the jury and the jury resolved this issue against defendants.

Dated November 19, 1965.

EARL R. LARSON.

Memorandum

The claimed newly discovered evidence relates to records of LPE which will show the state of the backlog of purchase orders at various times in the years 1952, 1953 and 1954. The affidavits indicate that these records were discovered in August, 1965, in the Chicago office of the corporate defendant sales organization.

Three of the complaints were filed in March of 1963 and the cases were not tried until May of 1965. The plaintiffs asked for damages totaling $2,000,000. The claims were therefore substantial. Competent counsel were employed and there was undoubtedly thorough preparation. The trial lasted parts of four weeks. Another trial would probably take more time. The new evidence does not justify a new trial. The Court does not have a transcript of the testimony. The Court's recollection is that there may have been some reference to backlog of orders. Defendants' position seems to be that the record of backlogs of orders would have some relevance to statements concerning the prospects of LPE. Assuming these records to be relevant, they relate to only a minor issue and hardly justify a new trial. The main issue was whether the defendants violated the Securities Act and on this issue the evidence was in direct conflict. The jury weighed the evidence and determined the credible evidence to be in favor of plaintiffs.

The claimed newly discovered evidence would not change the result.

Dated November 19, 1965.

EARL R. LARSON.

Memorandum Re "Jurisdiction"

(Filed Dec. 7, 1965)

Defendants in their motion papers claim that the Court has no jurisdiction because there is no evidence of the use of the mails or instrumentality of interstate commerce. Defendants do not argue this point in their briefs and may have abandoned the claim. Defendants did, however, assert this claim of lack of jurisdiction in their trial brief filed shortly after the commencement of the trial. Defendants' argument was based on the use of a telephone intrastate.

The evidence established that the mails were used in the transfer of payments for stock to Benn Myzel from LPS, and this meets the statutory requirement.

Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C.A. § 78j(b) (1958) prohibits in the purchase of securities certain manipulative or deceptive devices "by the use of any means or instrumentality of interstate commerce or of the mails."

The issue considered here is whether intrastate phone calls are sufficient to bring the action within the statutory language. It should be noted that this is primarily a question of whether a claim has been stated for which relief can be granted under the statute. Since plaintiff seeks to enforce a civil liability which has been held to be implicit in the Act, Federal jurisdiction would seem to follow. Section 27 of the Securities Exchange Act of 1934, 15 U.S.C.A. § 78aa, provides in part:

"The district courts of the United States, and the United States courts of any Territory or other place subject to the

jurisdiction of the United States shall have exclusive jurisdiction of violations of this chapter or the rules and regulations thereunder, and of all suits in equity and actions at law brought to enforce any liability or duty created by this chapter or the rules and regulations thereunder. . . ."

In view of this section, a jurisdictional challenge should perhaps be treated as a motion to dismiss for failure to state a claim, if timely, or as a motion for summary judgment. The latter approach was taken in Rosen v. Albern Color Research, Inc., 218 F. Supp. 473 (E.D. Pa. 1963).

The Rosen case involved phone calls within the same city. Judge Kraft held that such a transaction was not within the meaning of the statutory phrase "by the use of any means or instrumentality of interstate commerce." The issue has been squarely presented with reference to § 10(b) in only one other case. Nemitz v. Cunny, 211 F. Supp. 571 (N.D. Ill. 1963), involved telephone calls wholly within one State, although it does not appear whether they were within the same city. Judge Parsons held that a clear reading of the statute indicated that Congress intended to subject intrastate phone calls to the prohibitions of the statute.

Both courts agree that Congress has power to regulate intrastate activities which encroach upon or affect interstate commerce. In addition, both recognize that the telephone is an instrument of interstate commerce. However, they are in disagreement as to whether Congress intended § 10(b) to cover intrastate calls. I have concluded that intrastate phone calls meet the statutory requirements.

Legislative History And Congressional Purpose

The legislative history relating to the Securities Exchange Act of 1934 does not offer any direct evidence of congressional intent in choosing the phrase "instrumentality of interstate commerce." The Senate Committee on Banking and Currency did issue a Report based on an exhaustive investigation of stock exchange practices which it began in 1932. The purpose of the investigation was "to lay the foundation for remedial legislation." While the investigation was continuing, the Securities Act of 1933 and the Securities Exchange Act of 1934 were enacted. Although the Committee's report is comprehensive and detailed, it gives no aid in ascertaining congressional intent in reference to § 10(b). However, it does support a liberal construction of the Act.

"The Securities Act of 1933 and the Securities Exchange Act of 1934 have vested in the Securities and Exchange Commission jurisdiction over the source of and traffic in securities. The vigilant administration of these acts should materially abate, if not eradicate, abuses that have caused much economic distress. The establishment of an honest and true securities market is dependent upon the effective enforcement of the legislative mandates in these acts." Report of the Committee on Banking and Currency, H.R. No. 1455, 73rd Cong., 2d Sess. 394 (1934).

Although the legislative history is sparse, Congress did enumerate the national interests sought to be protected by the Act. Regulation of transactions in securities was deemed imperative—

"... in order to protect interstate commerce, the national credit, the Federal taxing power, to protect and make more effective the national banking system and Federal Reserve System, and to insure the maintenance of fair and honest markets in such transactions. ..." Securities Exchange Act of 1934, § 2, 15 U.S.C.A. 78b.

From this catalogue of Federal interests it seems reasonable to assume that Congress relied upon all of the corresponding Federal powers to support the Act. While it is true that Section 10(b) derives its vitality from the commerce power, in view of Congressional invocation of such a broad spectrum of Federal authority, it could be concluded that the intent was to exercise each power to its utmost. Applying this reasoning, intrastate phone calls would be subject to the Act.

The Statutory Language

The relevant language of Section 10(b) is as follows: "... *by the use of any* means or *instrumentality of interstate commerce.* ..." (Emphasis added.) The crucial inquiry is whether this phrase focuses upon the character of the telephone as an instrument of interstate commerce or whether it requires the telephone to be actually used in interstate commerce. In the Rosen case, the court adopted the "use" test, while in Nemitz the court looked only to the "character" of the instrument.

In determining which approach Congress intended, it may be helpful to look at the language employed in a similar section of the Securities Act of 1933. Section 17(a) of that Act provides:

"It shall be unlawful for any person in the offer or sale of any securities *by the use* of any means or instruments of transportation or communication *in interstate commerce* or by the use of the mails, directly or indirectly—. . . .". (Emphasis added.)

A comparison of the language employed in these two sections seems to demonstrate that on its face Section 10(b) focuses only upon the character of the instrument.

A student note in 62 Mich. L. Rev. 1080 (1964) asserts there is no difference in the *use of* an instrumentality of interstate commerce and its *use in* interstate commerce. The author's position is based on the assumption that Congress uses the prepositions "in" and "of" interchangeably. To support this proposition he relies upon the Wire Fraud Act, 66 Stat. 722 c. 879 § 18(a), 18 U.S.C.A. § 1343 (1964), which presently reads in part:

"Whoever, . . . transmits or causes to be transmitted *by means of wire,* radio, or television communication *in interstate or foreign commerce* . . ." (Emphasis added.)

Prior to an amendment in 1956 the statute read:

"Whoever, . . . transmits or causes to be transmitted *by means of interstate wire,* radio or television communication. . ." (Emphasis added.)

The 1956 amendment was apparently only for the purpose of including foreign commerce, but in the redrafting process the language was changed to focus upon the use of the designated means in interstate commerce. The Note writer apparently feels that the change was unconscious and has no substantive significance. From this he concludes that "in" and "of" are synonymous in Federal statutes.

Although the Note writer's position is plausible, I am inclined to agree with the court in Nemitz that a "clear reading" of Section 10(b) indicates that Congress intended to focus upon the character of the instrument. Although the draftsmen might have employed language requiring interstate use, the statute as written does not seem to impose such a requirement.

However, even if the statute does not demand that the use be interstate, it is possible to reason, as did the court in Rosen, that whether or not a facility is an instrument of interstate commerce depends upon the use to which it is put. In reaching the conclusion that the telephone is not an instrument of interstate commerce when used for a local call, the Rosen court relied upon Minneapolis & St. Louis R.R. Co. v. Winters, 242 U.S. 353, 37 S.Ct. 170, 61 L.Ed. 358 (1917). That case was decided under the Federal Employer's Liability Act, 35 Stat. 65, 45 U.S.C.A. § 51 (1958) which reads in part:

"Every common carrier by railroad while engaging in commerce between any of the several states * * *."

In the Winters case an employee brought an action for injuries suffered while working on an engine which had been used in hauling freight in interstate commerce. At the time of the injury, the engine was stationed in the company's yard and the Supreme Court held it was not then engaged in interstate commerce.

Unlike Section 10(b) the language of the F.E.L.A. seems to contemplate that the carrier be actually engaged in interstate commerce and thus the court's holding in Winters does not necessarily dictate the same approach in the present case. It appears that the Winters case has never been

directly overruled, but insofar as it is interpretative of the F.E.L.A., it is undoubtedly limited by the more liberal approach taken in later cases. See Southern Pac. Ry. Co. v. Gileo, 351 U.S. 493 (1956). In addition, the statute was amended subsequent to the Winters case to add the following:

"Any employee of a carrier, any part of whose duties as such employee shall be in furtherance of interstate or foreign commerce; or shall, in any way directly or close and substantially affect such commerce . . . shall be considered as entitled to the benefit of this chapter."

In Southern Pac. Ry. Co. v. Gileo, supra, the Court indicated that the amendment's purpose was to cure the restrictive approach taken to the statute.

Securities Act of 1933

Securities Act of 1933, §17(a), 15 U.S.C.A. § 77q(a)

The pertinent language of Section 17(a), quoted above, refers to the use of designated facilities *in* interstate commerce. Pointing out that the language of Section 17(a) is "substantially similar" to that of Section 10(b) of the 1934 Act, the Court in Rosen could "see no reason to attribute to Congress any different purpose or intent in the enactment of § 10(b) of the Securities Exchange Act." 218 F. Supp. at 476.

However, a student author in 5 Boston Col. Ind. & Com. L. Rev. 466 (1964) argues that it is significant that Section 10(b) uses the phrase "instrumentality of interstate commerce" rather than the language used in Section 17 (a) of the 1933 Act.

"This would indicate that Congress was shifting its aim from the incidental use to the instrument itself. In this light

the telephone is indisputably an instrument of 'interstate commerce.'" Boston Col. Ind. & Com. L. Rev. 466, 470. I find this approach persuasive in view of the fact that the language of the two sections is clearly different.

Securities Act of 1933, § 5, 15 U.S.C.A. § 77e(a)

In Lennerth v. Mendenhall, 234 F. Supp. 59 (N.D. Ohio 1964), the Court held, in the alternative, that an intrastate phone call satisfied the requirements of Section 5 of the Securities Act of 1933. That section provides:

"Unless a registration statement is in effect as to a security, it shall be unlawful for any person, directly or indirectly—(1) to make *use of any means* or instruments of transportation or *communication in interstate commerce* or of the mails to sell such security through the use or medium of any prospectus or otherwise. . . ." (Emphasis added.)

Plaintiffs had instituted an action based upon violation of the Securities Exchange Act of 1934 and then moved for summary judgment based upon alleged violation of Section 5 of the 1933 Act. In determining whether the requirements of that section had been met, the Court looked to the character of the telephone as an instrumentality of commerce and held that an intrastate use satisfied the Act. Alternatively, the Court held that a use of the mails also brought the action within Section 5.

"We find that the requirement that an interstate communication or the mail be used is amply satisfied. Defendant Roger used the telephone to arrange the second meeting with the plaintiffs; even though the call both originated from and was received in the state of Ohio, the requirements of the statute are satisfied. It is the character of the instru-

ment used, rather than the nature of the call, which determines. Use of the telephone is the use of a means of interstate communication." 234 F. Supp. at 63.

Although the 1933 Act might have been invoked in Lennerth on the basis of the use of the mails alone, the decision contradicts the position taken in Rosen that the 1933 Act emphasizes a use *in* interstate commerce.

Policy of the Act

The Michigan Law Review note, while disapproving the holding in Nemitz that Section 10(b) does cover intrastate calls, predicts that the precedents in favor of extensive securities regulation will ". . . be controlling if the intent of Congress in using the phrase 'instrumentality of interstate commerce' cannot be established." The same views are expressed by the Boston College Note writer.

"Since the heart of the question concerns how wide a net Congress intended to cast in using the words 'instrumentality of interstate commerce,' a logical key to the problem is the expressed purpose of the Act." 5 Boston Col. Ind. & Com. L. Rev. at 468.

Admittedly, the distinction between the *use of* an instrumentality of interstate commerce and a *use in* interstate commerce is a fragile one. However, there is ample precedent for giving a broad interpretation to Section 10 (b) and I agree with the law review commentators that a consideration of the evils sought to be remedied by the Act should lead to the conclusion that intrastate phone calls fall within the statutory language.

Dated December 6, 1965.

EARL R. LARSON
United States District Judge.

APPENDIX B-1

Judgment in Case No. 18,341

(Action Against Harry Fields)

IN THE

UNITED STATES COURT OF APPEALS

For the Eighth Circuit

No. 18,341. September Term, 1967.

Benjamin (Benn) Myzel, Philip Myzel, Zelman Levine, Clarence S. Levine, Orrin J. Levine, William P. Levine and Lakeside Industries, Inc., a Delaware corporation,
Appellants,

v.

Harry Fields.

APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF MINNESOTA

This cause came on to be heard on the record from the United States District Court for the District of Minnesota, and was argued by counsel.

On Consideration Whereof, It is now here Ordered and Adjudged by this Court that the judgment of the said District Court in this cause be, and the same is hereby, affirmed.

October 12, 1967.

APPENDIX B-2

Judgment in No. 18,342

(Action Against Samuel H. King)

UNITED STATES COURT OF APPEALS

For the Eighth Circuit

No. 18,342. September Term, 1967.

Benjamin (Benn) Myzel, Philip Myzel, Zelman Levine, Clarence S. Levine, Orrin J. Levine, William P. Levine and Lakeside Industries, Inc., a Delaware corporation,

Appellants,

v.

Samuel H. King.

APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF MINNESOTA

This cause came on to be heard on the record from the United States District Court for the District of Minnesota, and was argued by counsel.

On Consideration Whereof, It is now here Ordered and Adjudged by this Court that the judgment of the said District Court in this cause be, and the same is hereby, affirmed.

October 12, 1967.

APPENDIX B-3

Judgment in No. 18,343

(Action Against Rita Vertelney, Special Administratrix of the Estate of Joseph S. Vertelney)

UNITED STATES COURT OF APPEALS

For the Eighth Circuit

No. 18,343. September Term, 1967.

Benjamin (Benn) Myzel, Philip Myzel, Zelman Levine, Clarence S. Levine, Orrin J. Levine, William P. Levine and Lakeside Industries, Inc., a Delaware corporation,
Appellants,

v.

Rita Vertelney, Special Administratrix of the Estate of Joseph S. Vertelney.

APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF MINNESOTA

This cause came on to be heard on the record from the United States District Court for the District of Minnesota, and was argued by counsel.

On Consideration Whereof, It is now here Ordered and Adjudged by this Court that the judgment of the said District Court in this cause be, and the same is hereby, affirmed.

October 12, 1967.

APPENDIX B-4

Judgment in No. 18,344

(Action Against Gordon M. Cohen)

UNITED STATES COURT OF APPEALS

For the Eighth Circuit

No. 18,344. September Term, 1967.

Benjamin (Benn) Myzel, Philip Myzel, Zelman Levine, Clarence S. Levine, Orrin J. Levine, William P. Levine and Lakeside Industries, Inc., a Delaware corporation,

Appellants,

v.

Gordon M. Cohen.

APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE DISTRICT OF MINNESOTA

This cause came on to be heard on the record from the United States District Court for the District of Minnesota, and was argued by counsel.

On Consideration Whereof, It is now here Ordered and Adjudged by this Court that the judgment of the said District Court in this cause be, and the same is hereby, affirmed.

October 12, 1967.

APPENDIX C

Statutes and Rule

Section 10(b) of the Securities Exchange Act of 1934, 48 Stat. 891, 15 U.S.C. 78j(b), provides:

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange—
>
> * * * * *
>
> (b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

Section 28(a) of the Securities Exchange Act of 1934, 48 Stat. 903, 15 U.S.C. 78bb(a), provides:

> (a) The rights and remedies provided by this chapter shall be in addition to any and all other rights and remedies that may exist at law or in equity; but no person permitted to maintain a suit for damages under the provisions of this chapter shall recover, through satisfaction of judgment in one or more actions, a total amount in excess of his actual damages on account of the act complained of. Nothing in this chapter shall affect the jurisdiction of the securities commission (or any agency or officer performing like

functions) of any State over any security or any person insofar as it does not conflict with the provisions of this chapter or the rules and regulations thereunder.

Rule 10b-5 of the Securities and Exchange Commission, 17 CFR 240.10b-5, promulgated under the Securities Exchange Act of 1934, provides:

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,
>
> (1) To employ any device, scheme, or artifice to defraud,
>
> (2) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or
>
> (3) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person,
>
> in connection with the purchase or sale of any security.

SUPREME COURT, U. S.
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IN THE

Supreme Court of the United States

OCTOBER TERM, 1967

No. 996

BENJAMIN (BENN) MYZEL, *et al.*,
Petitioners,
v.
HARRY FIELDS,
Respondent.

BENJAMIN (BENN) MYZEL, *et al.*,
Petitioners,
v.
SAMUEL H. KING,
Respondent.

BENJAMIN (BENN) MYZEL, *et al.*,
Petitioners,
v.
RITA VERTELNEY, Special Administratrix, etc.,
Respondent.

BENJAMIN (BENN) MYZEL, *et al.*,
Petitioners,
v.
GORDON M. COHEN,
Respondent.

ON PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

BRIEF FOR RESPONDENTS IN OPPOSITION

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1967

No. 996

BENJAMIN (BENN) MYZEL, *et al.*, *Petitioners,*

v.

HARRY FIELDS, *Respondent.*

BENJAMIN (BENN) MYZEL, *et al.*, *Petitioners,*

v.

SAMUEL H. KING, *Respondent.*

BENJAMIN (BENN) MYZEL, *et al.*, *Petitioners,*

v.

RITA VERTELNEY, Special Administratrix, etc., *Respondent.*

BENJAMIN (BENN) MYZEL, *et al.*, *Petitioners,*

v.

GORDON M. COHEN, *Respondent.*

ON PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

BRIEF FOR RESPONDENTS IN OPPOSITION

Opinions Below

The opinion of the Court of Appeals (A. 1-53) is reported in CCH FED. SEC. L. REP. ¶92,005.

Questions Presented

Respondents do not dispute that the questions set forth in Petition 2 are those Petitioners attempt to present. However, in assessing the merits of whether certiorari should be granted, the Court should be aware that most of the "questions presented" would not be reached even if certiorari were granted: Petitioners' Questions A and C are not, in fact, "presented" because they were not preserved below (see pages 17-18 and 22, *infra*); Petitioners' Question D was a mere alternative ground in the courts below (see pages 15-16, *infra*); and Petitioners' Question F is based upon nothing more than a gross mischaracterization of isolated language in the Court of Appeals opinion (see pages 30-31, *infra*).

Statement

The following additional facts are essential to due consideration of the Petition. The corporate Petitioner is the successor of Lakeside Plastics and Engraving Co. ("LPE"), a Minnesota company (III R. 1), with offices in Duluth (R. 502), and Lakeside Plastics Sales Co. ("LPS"), an Illinois company (III R. 4), with offices in Chicago (R. 460). (III R. 19-21.)

Petitioners Benn Myzel and Philip Myzel, acting on behalf of the other individual Petitioners and of the predecessor to the corporate Petitioner, purchased stock in LPE from Respondents by use of misrepresentations and omissions of material facts. Since Petitioners do not dispute the sufficiency of the evidence to support recovery except with respect to the purchase from Respondent Vertelney, only the facts as to that purchase will be stated.

Vertelney bought his stock in LPE on the strong recommendations of his good friend, Petitioner Benn Myzel (R. 303, 305). Benn Myzel was a cousin (S.R. 310) of and "consultant and advisor" to LPE's president and "intimately knew" LPE's affairs (R. 524). LPE's records showed Vertelney, who had not been a director since 1949 (R. 475-76), was re-elected to the board in 1952 (R. 476). The evidence is uncontroverted that only one meeting occurred in 1953 prior to his sale of stock, and that meeting lasted only 35 minutes (R. 479-80).

About a month before Vertelney sold his stock, Petitioner Zelman Levine approached him and asked if he wanted to sell his stock, and Vertelney said he did not (R. 316).

Petitioner Phil Myzel, acting as "agent" for Benn Myzel (S.R. 319, 322), purchased Vertelney's stock late in 1953 (R. 314). Phil Myzel made the following statements to Vertelney during the transaction:

> "It looks like these guys [LPE] are having kind of a rough time. Maybe you'd like to dispose of your stock" (R. 314).
>
> "It doesn't look like they are going to do very much with that Lakeside Plastics, and Benn wants to get rid of some of his stock, too, because he doesn't think they are going anywhere. He thought maybe you should get rid of it, too" (R. 315).
>
> "Heck, the thing is going to go bankrupt. They are not doing too good and it looks like Benn is going to get out and it would be a good idea for you to get out, too" (R. 315-16).

When Vertelney asked, "Does he [Benn Myzel] know so much more about what is going on out there than I do?", Phil Myzel answered:

> "Yes. These guys out there, they seem to be giving him the shim-sham. They are not giving straight answers at all. He thinks they are liable to go broke altogether. You'd be smart to sell your stock" (R. 315).

Aside from these negative observations, Phil Myzel admitted that he disclosed no information to Vertelney about how the company was actually doing (S.R. 396).

The statements that Benn Myzel did not think the LPE stock was "going anywhere" and thought LPE was "liable to go broke altogether and was therefore going "to get rid of some of his stock" and was "going to get out" were untrue. In fact, Benn Myzel testified he was always optimistic about the company (R. 612, 636), always felt it had a bright future and would be a success, and knew that "business was going up as far as sales" (R. 612). He never "got out"—he was employed by the corporate Petitioner up through the time of trial (R. 524, 569).

Vertelney made up his mind that

> "* * * it didn't look like a very good investment anymore, especially if Benn was going to get out of it because he was the original promoter of this thing. He is the one that pushed it so far, I would have thought that if he would get out, I better get out, too" (R. 315).

Shortly after Vertelney sold his stock, he saw Benn Myzel on occasion, and Benn would state that LPE was "still not doing too good," and was doing "pretty lousy" (R. 319). Between 1953 and 1962, Vertelney did not discuss LPE with anyone (R. 320) and did not suspect he had sold for too small a price until 1962 (R. 321).

Benn Myzel later transferred the stock to LPS (III R. 8-11). It was uncontradicted that LPS sent checks in

payment for the stock from its offices in Chicago, Illinois, to Benn Myzel in Minnesota (R. 711-12; see R. 455-58). LPE gave Benn Myzel a $35,000 contract for his services as a "management consultant" at least partly because of his having obtained the stock (R. 139-41, 536). The shares were subsequently acquired by LPE and retired (III R. 20).

The case was submitted to the jury, and the following general instructions were given by the trial court relating to the nature of the factual findings required:

> "The main questions of fact to be decided by you are:
>
> "1. Did the defendants directly or indirectly use manipulative or deceptive conduct in buying the stock of each of the plaintiffs?
>
> "2. If there was such conduct, did the defendants use any means, or instrumentality of interstate commerce or the mails in doing so?
>
> "3. If there was such conduct on the part of the defendants, did this conduct consist of the making of untrue statements as to a material fact or did it consist of omission to state a material fact which was necessary to prevent the statement or statements that were made misleading? Or did it consist of the failure to disclose a known fact or facts which the defendants should reasonably have known would be important to the plaintiffs in determining the value of the stock they held?
>
> "4. If there were misrepresentations or omissions, were they made with the intent of inducing the plaintiffs to sell their stock?
>
> "5. If there were misrepresentations or omissions, did they relate to material facts?
>
> "6. Did each plaintiff rely on the claimed misrepresentations or omissions?" (R. 782-83).

The trial court then instructed as to jurisdiction:

> "It is for you to determine whether an instrumentality of interstate commerce, such as the telephone, or the mails, was used by a defendant, or defendants, in connection with the purchase of the stock of a particular plaintiff" (R. 785).

as to corporate liability:

> "Reference has been made to defendant Lakeside Industries, Inc., as a successor corporation to Lakeside Plastics & Engraving Company and other companies.
>
> "The law holds a corporation responsible for all unlawful acts of its directors, officers, employees or other agents, provided such unlawful acts are done in the ordinary course of their employment or in the ordinary course of the corporation's business" (R. 789).

and as to damages (inter alia):

> "If you believe that the net result of full disclosure would have been that a plaintiff would have retained his stock as an investment rather than selling it to defendants at a higher price, you should consider the subsequent increases in the value of the stock over what you consider a reasonable period as part of the losses of a plaintiff which he is entitled to recover.
>
> "What constitutes a reasonable period is for you to determine upon all the facts of this case. You should bear in mind that the statute is not intended to provide investors with an insurance policy against market changes. It does, however, seek to prevent those who have engaged in fraudulent or illegal conduct from benefiting by that conduct" (R. 793).

The trial court twice read to the jury §10(b) of the Securities Exchange Act of 1934, 15 U.S.C. 78j and Rule 10b-5 (R. 784-85).

Petitioners objected to the trial court's instruction on damages to the extent it authorized damages measured by the value of the shares at any time after the date of sale, and to the trial court's refusal to give their requested instruction restricting consideration of facts bearing on valuation to the date of sale (R. 802, 823-24). Petitioners also objected to the trial court's instruction that an intrastate communication by telephone could constitute use of an instrumentality of interstate commerce (R. 801). Finally, Petitioners objected to the trial court's failure to give their requested instructions that to find liability, the jury had to find that the misrepresentations or omissions were made with knowledge of their false or misleading nature, and with the intention to deceive (R. 834, 836).

Although an instruction on the statute of limitations was requested (R. 839), and one was given (R. 793-94), Petitioners, consistent with their view that laches was not an available defense in an action tried to a jury (R. 62; S.R. 11), requested no instruction on laches, and did not object to the trial court's failure to give an instruction on that defense.

The jury returned verdicts for Respondents and against Petitioners. In denying Petitioners' motions for judgment notwithstanding the verdict or for a new trial, the trial court held, inter alia, on the matter of jurisdiction, that:

> "The evidence established that the mails were used in the transfer of payments for stock to Benn Myzel from LPS. and this meets the statutory requirement" (A. 71).

Judgments were entered and Petitioners appealed to the Court of Appeals for the Eighth Circuit, asserting, inter alia, that the trial court erred in instructing that intrastate use of the telephone is use of an instrumentality of interstate commerce (App. Br. 83-85); in holding that the corporate defendant could be held liable (App. Br. 78-79); and in allowing damages to be tested by the value of the stock at any time after the time of sale (App. Br. 51-71). Before the Court of Appeals, Petitioners did not assert any error in the failure to instruct the jury concerning laches as a defense, nor did they argue that the existence of scienter was a finding prerequisite to liability.

The Court of Appeals held that jurisdiction under the Act and Rule 10b-5 was sustained both by interstate delivery of checks and by intrastate use of the telephone (A. 2-5); that the corporate Petitioner was properly held liable (A. 49-51); that Respondent Vertelney was properly accorded recovery (A. 21-25); and that the measure of damages was proper (A. 32-49). Although the issues were not properly presented, the Court of Appeals also expressed its view that the defense of laches, "an issue upon which neither the judge or the jury passed," was "not applicable where the action was properly tried at law to a jury" (A. 35), and that "Proof of 'scienter,' i.e., knowledge of the falseness of the impression produced by the statements or omissions made, is not required under Section 10(b) of the [Securities Exchange] Act" (A. 19).

Summary of Argument

There are no "special and important reasons," within the meaning of Rule 19, for granting review. Petitioners present no "real and embarrassing conflict of opinion and

authority." *Layne & Bowler Corp.* v. *Western Oil Works, Inc.*, 261 U. S. 387, 393 (1923). The case-by-case development of the relevant law regarding the issues herein is satisfactory. See *Maryland* v. *Baltimore Radio Show, Inc.*, 338 U. S. 912, 918 (1950).

A. Jurisdiction

The holding that §10(b) jurisdiction may be based on intrastate telephone use was only an alternative ground for sustaining jurisdiction (A. 5, 71). It thus provides a question which is presented "abstractly" rather than "in the context of meaningful litigation." *The Monrosa* v. *Carbon Black Export, Inc.*, 359 U. S. 180, 183, 184 (1959).

There is no conflict with any court of appeals decision. With the exception of *Rosen* v. *Albern Color Research, Inc.*, 218 F. Supp. 473 (E.D. Pa. 1963), the authorities accord with the alternative holding herein. See *Nemitz* v. *Cunny*, 221 F. Supp. 571 (N.D. Ill. 1963); *Bredehoeft* v. *Cornell*, 260 F. Supp. 557 (D. Ore. 1966).

B. Laches

(1) *Preservation.* Petitioners did not properly preserve the laches issue in either court below. *Quicksall* v. *Michigan*, 339 U. S. 660, 663 n. 3 (1950). They requested no instruction on laches and did not object to the omission of such an instruction, F.R. Civ. P. 51; *Lopez* v. *United States*, 373 U. S. 427, 436 (1963); *Howitt* v. *United States*, 328 U. S. 189, 191 n. 3 (1946); they did not assert laches as a defense before the Court of Appeals. *California* v. *Taylor*, 353 U. S. 553, 556 n. 2 (1957).

(2) *Facts.* The record contains no facts showing any evidentiary basis to support a laches defense. Laches requires not only evidence of delay, but proof of prejudice.

Gutierriz v. *Waterman S.S. Corp.*, 373 U. S. 206, 215-16 (1963).

(3) *Conflict.* There is no conflict with any court of appeals decision. *Royal Air Properties, Inc.* v. *Smith*, 312 F. 2d 210 (9th Cir. 1962) does not hold to the contrary of the present Court of Appeals' statement. The Court's statement is correct. *Straley* v. *Universal Uranium & Milling Corp.*, 289 F. 2d 370 (9th Cir. 1961); see *Holmberg* v. *Armbrecht*, 327 U. S. 392, 395 (1946).

C. Scienter

This Court should refuse to review Petitioners' "scienter" issue for the following reasons:

(1) Petitioners did not present this issue to the Court of Appeals. *California* v. *Taylor*, 353 U. S. 553, 556 n. 2 (1957).

(2) The testimony of the Petitioners who made the representations showed as a matter of law that each knew that the opposite of the impressions produced by the misrepresentations or omissions was true (R. 612, 636, 683; S.R. 395).

(3) There is no conflict with any court of appeals decision. The court in *Fischman* v. *Raytheon Mfg. Co.*, 188 F. 2d 783 (2d Cir. 1951) did not state that "scienter" was required, but that "fraud" was. The authorities cited by the *Fischman* court show that it did not mean "fraud" as understood at common law, where "scienter" was required. Several district courts in the Second Circuit agree that "scienter" is not required. *Miller* v. *Steinbach*, 268 F. Supp. 255, 279 (S.D.N.Y. 1967); *SEC* v. *Texas Gulf Sulphur Co.*, 258 F. Supp. 262, 277-78

(S.D.N.Y. 1966); *Dack* v. *Shanman,* 227 F. Supp. 26, 29 (S.D.N.Y. 1964). The reasoning of the cases holding "scienter" not required (*e.g., Ellis* v. *Carter,* 291 F. 2d 270 (9th Cir. 1961); *Texas Continental Life Ins. Co.* v. *Bankers Bond Co.,* 187 F. Supp. 14 (W.D. Ky. 1960) *reversed on other grounds,* 307 F. 2d 242 (6th Cir. 1962)) is clearly correct and will be adopted by courts of appeal.

(4) *Satisfactory Development.* Because of the many situations to which §10(b) can be applied and the range of proof requirements which might be formulated, the Court should have the aid of the thinking of as many courts of appeal as possible before considering this issue. See *Maryland* v. *Baltimore Radio Show, Inc.,* 338 U. S. 912, 918 (1950).

D. Corporate Petitioner's Liability

As to the routine issue of the corporate Petitioner's liability, Petitioners do not assert a conflict. Petitioners otherwise show no reason justifying this Court's consideration.

E. "Grossly Negligent Plaintiff"

The argument that Respondent Vertelney was "grossly negligent" is based upon a false premise. A reading of the opinion (A. 22-25) shows clearly that the Court of Appeals affirmed the jury finding that Respondent Vertelney acted reasonably, and directed its "grossly negligent" language only to the hypothetical situation which would exist had the representations concerned only financial condition and business affairs.

F. Damages

The holding on damages does not conflict with any court of appeals decision. *Estate Counselling Service* v. *Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 303 F. 2d 527 (10th Cir. 1962), applying the "out-of-pocket" rule to a *purchaser* of stock in no way governs §10(b) cases brought by *sellers* of stock. The purchaser loses only the definite amount of money paid. The seller who would have retained his stock loses the appreciation in value; the Court's holding correctly recognizes this difference. The innocent party rather than the wrongdoer should receive such appreciation. *Janigan* v. *Taylor*, 344 F. 2d 781 (1st Cir.), *cert. denied*, 382 U. S. 879 (1965).

Reasons for Denying the Writ

Introduction

Rule 19 emphasizes that the discretionary power to grant review on certiorari in federal cases will be exercised "only where there are special and important reasons therefor." There are no "special and important reasons" for granting review in this case.

Petitioners' references (Petition 10) to the "significant impact" of the Court of Appeals decision upon themselves, and to the amount of the verdict and the identity of some of the parties, are totally inapposite. The purpose of certiorari is to serve the "interest of the law, not the interest of the particular parties," and "[i]t is not the importance of the parties or the amount involved that is controlling." Mr. Chief Justice Hughes, Address to American Law Institute, May 10, 1934, in HART & WECHSLER, THE FEDERAL COURTS AND THE FEDERAL SYSTEM 1395,

1396 (1953). Certiorari is concerned only with "questions whose resolution will have immediate importance far beyond the particular facts and parties involved." Mr. Chief Justice Vinson, Address to American Bar Association, September 7, 1949, in HART & WECHSLER, THE FEDERAL COURTS AND THE FEDERAL SYSTEM 1403, 1404-05 (1953). See *Rice* v. *Sioux City Memorial Park Cemetery,* 349 U. S. 70, 74 (1954).

Far from presenting any "real and embarrassing conflict of opinion and authority between the * * * courts of appeal," *Layne & Bowler Corp.* v. *Western Well Works, Inc.,* 261 U. S. 387, 393 (1923), Petitioners, as to each issue, assert either no court of appeals conflict at all (see Petition 19-20, 20-21), or at most, an imaginary inconsistency. None of the questions involved herein is, within the meaning of Rule 19, "an important question of federal law which has not been, but should be, settled by this Court." Rather, most are questions which have never previously been treated by a court of appeals. All are questions which are just now receiving treatment by the lower courts (many at the pleading stage).[1]

There is nothing to indicate that the case-by-case development of the relevant law by the lower courts is unsatisfactory. As stated by Mr. Justice Frankfurter

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1. "[M]ost of 10b-5 law (and, until recent years, practically all of it) is from the District Courts." BROMBERG, SECURITIES LAW: FRAUD §1.3(2) (1967). This is not surprising. The Securities Exchange Act of 1934, 48 Stat. 881 (1934); 15 U.S.C. 78 et seq., is approximately 34 years on the books. Rule 10b-5 was not promulgated until 1942. Exchange Act Release No. 34-3230 (May 21, 1942), 13 FED. REG. 8177. Civil liability for violation of Rule 10b-5 goes back no further than *Kardon* v. *National Gypsum Co.*, 69 F. Supp. 512 (E.D. Pa. 1946), and lower courts were still holding no civil recovery under § 10(b) as late as 1954. *Beury* v. *Beury*, 127 F. Supp. 786 (S.D. W. Va. 1954), *appeal dismissed*, 222 F. 2d 464 (4th Cir. 1955). (Court of Appeals stated disapproval in dicta).

in his opinion respecting denial of certiorari in *Maryland* v. *Baltimore Radio Show, Inc.*, 338 U. S. 912 (1950):

> "It may be desirable to have different aspects of an issue further illumined by the lower courts. Wise adjudication has its own time for ripening." 338 U. S. at 918.

But an overriding consideration in exercising the discretionary power to grant review is the question of what ultimately *can* be decided by the Court if certiorari should issue, *i.e.*, do the questions presented have the procedural credentials qualifying them for review. Most of the points asserted in this case do not. Two of the points were not preserved by Petitioners in the courts below. One was merely an alternative ground. Another is based on no other foundation than a gross mischaracterization of isolated language in the Court of Appeals opinion.

Respondents feel that the matters asserted by Petitioners may be treated conveniently in the following order:

(a) Jurisdiction under the Securities Exchange Act.

(b) Laches.

(c) Scienter.

(d) Liability of corporate defendant.

(e) "Grossly negligent plaintiff."

(f) Measure of damages.

A. The decision below, alternatively basing jurisdiction or intrastate telephone use, does not conflict with any court of appeals decision.

Petitioners question the view of the district court and of the Court of Appeals that intrastate telephone use can

supply a basis for jurisdiction under §10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 (Petition 19-20). The Court should not grant review of this issue because it was but an alternative ground for sustaining jurisdiction. The trial court, in accordance with uncontradicted testimony of one of the Petitioners (R. 711; see R. 455-56), correctly stated that:

> "The evidence *established* that the mails were used in the transfer of payments for stock to Benn Myzel from LPS, and this meets the statutory requirement" (A. 71). [Emphasis added.]

Likewise, the Court of Appeals found the established interstate transactions sufficient in themselves for sustaining jurisdiction:

> "But there exists additional grounds to sustain jurisdiction. It is the rule that where any interstate use is made to perpetuate the original fraudulent concealment or transaction, even though not part of the original solicitation or inducement of sale involved, then nevertheless the subsequent use of interstate facilities in furthering the scheme is sufficient to establish federal jurisdiction. *Creswell-Keith, Inc.* v. *Willingham,* 264 F. 2d 76, 80, 82 (8 Cir. 1959); see also *Thomas* v. *United States,* 227 F. 2d 667, 670 (9 Cir. 1955) [*cert. denied,* 350 U. S. 911 (1955)] [use of automobile]; *Ellis* v. *Carter,* 291 F. 2d 270, 274 (9 Cir. 1961) [use of plane]; cf. *Boone* v. *Baugh,* 308 F. 2d 711 (8 Cir. 1962).
>
> "[Respondents] * * * contended that they were fraudulently induced to sell their stock to the [Petitioners], that the purchases were made by parties (the Myzels) other than the true buyers (the Levines) and that an Illinois corporation owned by some of the [Petitioners] was used as a conduit of

> concealment. The transfers of the stock to the Illinois corporation, although occurring several months and even years later, involved the delivery of checks written by the Illinois corporation on Chicago, Illinois banks to a Minnesota citizen. Cf. *Little* v. *United States,* 331 F. 2d 287 (8 Cir. 1964) [*cert. denied,* 379 U. S. 834 (1964)]. Thus, under [Respondents'] * * * theory, there was also sufficient evidence of interstate transactions to sustain jurisdiction" (A. 5).

The foregoing shows that resolving the jurisdictional question posed by Petitioners would not affect the result in this case. It would provide an interesting intellectual exercise but an academic result, and a waste of judicial energy. See *Rice* v. *Sioux City Memorial Park Cemetery,* 349 U. S. 70, 74 (1955). While it may have been proper for the Court of Appeals to pass upon both grounds, this Court decides questions only "in the context of meaningful litigation" and resolution of the question here presented can well "await a day when the issue is posed less abstractly." *The Monrosa* v. *Carbon Black Export, Inc.,* 359 U. S. 180, 183, 184 (1959). See *Tomoya Kawakita* v. *United States,* 343 U. S. 717, 731 (1952).

Not only is the jurisdictional question academic, it is not the subject of any other court of appeals decisions. And with the exception of one district court decision, *Rosen* v. *Albern Color Research, Inc.,* 218 F. Supp. 473 (E.D. Pa. 1963), the authorities uniformly agree that intrastate telephone use is a basis for §10(b) jurisdiction. See *Nemitz* v. *Cunny,* 221 F. Supp. 571 (N.D. Ill. 1963); *Bredehoeft* v. *Cornell,* 260 F. Supp. 557 (D. Ore. 1966) (alternative ground); *Lennerth* v. *Mendenhall,* 234 F. Supp. 59, 63 (N.D. Ohio 1964) (similar language in §5 of the Securities Act of 1933, 15 U.S.C. §77e); 5 B.C. Ind. & Com. L. Rev. 466 (1964).

The lower courts need no guidance to see the error made by the district court in *Rosen* v. *Albern Color Research, Inc., supra,* and to develop the correct rule accordingly, In *Rosen,* the court relied, as do Petitioners, upon *Minneapolis & St. L. R.R.* v. *Winters,* 242 U. S. 353, 357 (1917). This approach ignores the fact that the issue in that case was whether, under the Federal Employer's Liability Act, 35 Stat. 65, 45 U.S.C. §51, the plaintiff was *employed in* interstate commerce at the time of injury, not whether an *instrumentality of* interstate commerce was involved. The approach also ignores this Court's many decisions since *Winters* that Congress may regulate intrastate activity if it involves an instrumentality of interstate commerce. *Alstate Constr. Co.* v. *Durkin,* 345 U. S. 13 (1953) (making product for instrastate application to interstate roads); *Overstreet* v. *Northshore Corp.,* 318 U. S. 125 (1943) (operation of toll road and bridge located wholly within one state); *Weiss* v. *United States,* 308 U. S. 321 (1939) (prohibition of interception and divulgence covers intrastate telephonic messages).

B. The defense of laches was not presented procedurally or factually; moreover, the Court of Appeals statement thereon does not conflict with any court of appeals decision.

The Petition asserts at page 18 that "the court below erred in holding that the defense of laches was not applicable to a Rule 10b-5 cause of action 'properly tried at law to a jury'" (A. 35).

(1) *Preservation.* It first should be noted that Petitioners did not, at any stage of the proceedings, properly preserve the issue asserted. As the Court of Appeals

stated, whether Petitioners were entitled to invoke the defense of laches was "an issue upon which neither the judge or the jury passed" (A. 35). Petitioners made no request to the trial court to instruct the jury on laches or unreasonable delay, even though they submitted a requested instruction on the statute of limitations (R. 839). Nor did they object to the trial court's omission of an instruction on laches. F.R. Civ. P. 51 states in relevant part:

> "No party may assign as error the giving or failure to give an instruction unless he objects thereto before the jury retires to consider its verdict, stating distinctly the matter to which he objects and the grounds of his objection."

This is a classic case of waiver under Rule 51. Raising laches as a defense at this juncture is totally improper and should be disregarded by the Court. *Lopez* v. *United States,* 373 U. S. 427, 436 (1963); *Howitt* v. *United States,* 328 U. S. 189, 191 n. 3 (1946).

Nor did Petitioners assert the existence of laches as a defense before the Court of Appeals. At most, they posed a laches-like argument, since abandoned, which they believed relevant to their argument on the measure of damages. (Appellant's Brief 65; see Appellant's Reply Brief 16). The fact that the Court of Appeals proceeded to express its opinion on laches does not resurrect for Petitioners an issue which they have already waived. Because the issue was not properly raised in the Court of Appeals is reason enough to refuse to consider it in this Court, *California* v. *Taylor,* 353 U. S. 553, 556 n. 2 (1957); certainly Petitioners may not assert it here when they have not properly preserved it in *either* court below. *Quicksall* v. *Michigan,* 339 U. S. 660, 663 n. 3 (1950).

(2) *Facts.* The obvious reason for Petitioners' failure to preserve the issue of laches is the absence of any facts showing an evidentiary basis to support the defense. Laches cannot now be raised by Petitioners in the abstract. Establishing a laches defense requires not only evidence of an unreasonable delay before asserting a claim, but also *some* proof of prejudice resulting from the delay. *Gutierriz* v. *Waterman S.S. Corp.*, 373 U. S. 206, 215-16 (1963). At no time during any of the proceedings was any evidence adduced which even suggested prejudice resulted from the timing of Respondents' actions against Petitioners. Petitioners do not now and never did claim the contrary. Thus, not only is the question of laches not procedurally presented; it is not factually presented either.

(3) *Conflict.* Procedural and factual inadequacies aside, the Court of Appeals' answer to Petitioners' question is not in conflict with any other court of appeals decision. *Royal Air Properties, Inc.* v. *Smith*, 312 F. 2d 210 (9th Cir. 1962), the only court of appeals decision cited by Petitioners[2] (at page 18), was a §10(b) action for rescission. The trial court held the defenses of waiver, estoppel and laches unavailable. The Court of Appeals for the Ninth Circuit reversed, holding that nothing in §10(b) indicated

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2. The Court of Appeals decision in *Tobacco and Allied Stocks, Inc.* v. *Transamerica Corp.*, 244 F. 2d 902 (3d Cir. 1957), did no more than adopt the routine approach and apply laches as a defense to an equitable claim.

The only case holding to the contrary of the present Court of Appeals statement is a district court decision, *Pitofsky* v. *Brucker*, CCH FED. SEC. L. REP. ¶91,715 (S.D.N.Y. 1966), cited by Petitioners at 18. That case involved an action for damages under Rule 10b-5, but the court's holding at the pleading level that defendant should be given an opportunity to show laches was made without any analysis or discussion, and was only an alternative ground for the decision. The existence of this case certainly is not sufficient justification to obtain this Court's consideration.

an intent to exclude the "traditional" defenses. It said nothing concerning the employment of laches as a defense in legal actions or actions tried at law to a jury as Petitioners subtly imply. In effect, the Court was holding only that the "normal defenses" otherwise available at common law were available against claims made under §10(b).[3]

Aside from the lack of conflict, the Court of Appeals view was clearly correct. And *Straley* v. *Universal Uranium & Milling Corp.*, 289 F. 2d 370 (9th Cir. 1961), holding the defense of laches inapplicable where the action is one at law, is in accord. The Court of Appeals properly stated that the applicable measure of the timeliness of the suit was the Minnesota statute of limitations, and the trial judge correctly instructed on that basis. See *Holmberg* v. *Armbrecht*, 327 U. S. 392, 395 (1946):

> "As to actions at law, the silence of Congress has been interpreted to mean that it is federal policy to adopt the local law of limitation."

The mere fact that Respondents' original prayer asked for equitable relief does not require that equitable defenses be applied to the alternatively requested *legal* relief to which Respondents were entitled. See *Lydle* v. *Scott*, 157 F. Supp. 729 (N.D. Ohio 1957).

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3. A careful reading of *Royal Air Properties, Inc.* v. *Smith* and *Tobacco and Allied Stocks, Inc.* v. *Transamerica Corp.*, 143 F. Supp. 323 (D. Del. 1956), *aff'd*, 244 F. 2d 902 (3d Cir. 1957), reveals that neither court was faced with the question posed here by Petitioners: *i.e.*, whether laches is available as a defense in actions at law. Both courts did state that characterizations of claims in the complaint as "legal" would not be dispositive of whether equitable defenses might be available. With this principle, Respondents have no quarrel.

C. The Court of Appeals observation on "scienter," an issue not actually presented to it, does not conflict with any court of appeals decision.

Petitioners attempt to raise for review the question whether "proof of 'scienter,' i.e., knowledge of the falseness of the impression produced by the statements or omissions made," is required in a §10(b) action.[4] (Petition 11.) The Court should deny review because (1) Petitioners failed to properly raise scienter as an issue before the Court of Appeals; (2) Petitioners' theory of scienter is logically inapplicable to the facts of this case; (3) no con-

4. The casual reference by Petitioners to commentators as requiring "some degree of scienter" (Petition at 15), subtly attempts to water down the burden of supporting the assertion that the district court erred when it failed to instruct the jury using their theory of scienter as embodied in their requested instructions (Request Nos. 1(2) and 5 at R. 834, 836). If those instructions are incorrect there is no error in refusing to give them. *Baltimore & O. Ry.* v. *Felgenhauer*, 168 F. 2d 12, 18 (8th Cir. 1948). None of the commentators cited would support anything like the instructions Petitioners requested. Thus, 3 Loss, SECURITIES REGULATION 1766 (2d ed. 1961) observes that the courts may require, not "scienter," but "some sort of watered-down *scienter* element." Such a requirement could well be satisfied by showing "constructive fraud," i.e., making a statement with reckless disregard of its truth or falsity, *Trussel* v. *United Underwriters, Ltd.*, 228 F. Supp. 757, 772 (D. Colo. 1964), just as the requirement that an act be done "willfully" may be satisfied by showing it was done "without justifiable excuse," "stubbornly, obstinately, perversely," or with "careless disregard whether or not one has the right to so act," *United States* v. *Murdock*, 290 U. S. 389, 394 95 (1933). Comment, *Negligent Misrepresentations Under Rule 10b-5*, 32 U. CHI. L. REV. 824, 838 (1965). The balance of the authorities support the court's refusal to instruct. Fleischer, *"Federal Corporation Law": An Assessment*, 79 HARV. L. REV. 1146, 1178 and n. 147 (1965) states only that "some degree of wilfullness" may be required and that " 'constructive' knowledge is enough, *i.e.*, that the defendant should have known of the misstatement." The author of Note, 63 MICH. L. REV. 1070 (1965) concludes that plaintiff need only show that "considering all the circumstances, and particularly that of accessibility to the facts, the defendant did not act as would the ordinarily prudent person to avoid misrepresentation, either express or by omission." 63 MICH. L. REV. at 1079.

flict with any Court of Appeals decision exists; and (4) the lower courts' case-by-case development of the law on this issue is satisfactory.

(1) *Preservation.* The issue of scienter is improperly presented as a question in this case in that Petitioners did not raise it on appeal before the Court of Appeals. They may not properly raise it here, having (understandably, in light of the evidence)[5] abandoned it there.[6] *California* v. *Taylor, supra,* 353 U. S. 553, 556 n. 2 (1957).

(2) *Inapplicability.* Because they were not present at trial, it is understandable that present Counsel for Petitioners could overlook the fact that their theory of "scienter" could not logically apply to the facts of the case. The trial court's refusal to instruct on "scienter" (as

5. It is inconceivable that the jury could have found under any circumstances, that the representations or omissions were innocent, as claimed by Petitioners (Petition at page 14). On the one hand, Respondents claimed that definite and affirmative misrepresentations were made concerning the financial condition and prospects of LPE; on the other hand, Petitioners Benn and Phil Myzel both claimed that no representations of any kind were made. No middle ground having been presented, it was merely a question of whom to believe. Naturally, the veracity and credibility of the witnesses was left to the jury. But some idea of the weight which could be accorded to these Petitioners' testimony can be obtained by glancing through a few pages of it. See, *e.g.,* R. 577-80, 584-85, 597-98, 661-64, 672-73. It is no small wonder that the "jurors determined the plaintiffs were telling the truth and that defendants were not." Opinion of United States District Court at A. 62. The District Court observed that it "could add its own evaluation of the credibility of some of the defendants, but * * * [would] refrain from doing so." *Ibid.* And the Court of Appeals described Petitioners' testimony as "taxing even the most credulous mind" (A. 23).

6. The observations made by the Court of Appeals on the doctrine of scienter were prompted by Petitioners' confusing claim before that court that scienter to some extent governed the *measure of damages* (App. Br. 59-62). This claim is of an entirely different nature than the new claim (not argued, briefed or assigned as error before the Court of Appeals) that scienter is a necessary requisite for establishing *liability.*

Petitioners understand the term) is supported not only on the ground that such "scienter" is not requisite of a §10(b) case, but also on the ground that any representations or omissions were, as a matter of law, made with knowledge of the falseness of the impressions they produced. The jury found false or misleading misrepresentations or omissions about the financial condition and value of LPE and the future position of Benn Myzel in LPE stock. Contrary to Petitioners' claim that these misrepresentations or omissions could have been inaccurately but nevertheless "honestly" made (see Petition at 14), the actual testimony of Messrs. Myzel shows without contradiction that each knew that the opposite of the impressions produced by the misrepresentations or omissions was true. Petitioner Benn Myzel insisted that he was *"always"* optimistic about the company (R. 612, 636), *"always"* felt it had a "bright future" and would be a success, and *"Knew,* too, that business was going up as far as sales" (R. 612). [Emphasis added.] Petitioner Phil Myzel testified that he *"knew"* the company's stock "eventually * * * would be worth something," and that he "had faith in the boys" (R. 683) [emphasis added], and that Benn Myzel had advised him that they should "hang onto" their stock because the company "eventually * * * will be all right" (S.R. 395). The verdict establishes that false or misleading representations or omissions were made. They could not be made innocently by witnesses who insist they "knew" otherwise.

(3) *Conflict.* In addition to the foregoing reasons for denying review, no real and embarrassing conflict exists between courts of appeals. No court of appeals has held to the contrary of the statement by the Court below that "proof of 'scienter,' i.e., knowledge of the falseness of the impression produced by the statements or omissions made,

is not required under Section 10(b) of the Act" (A. 19). Petitioners assert that *Fischman* v. *Raytheon Mfg. Co.*, 188 F. 2d 783 (2d Cir. 1951), holds that such "scienter" is required for a §10(b) action. It is clear it does not. The question in that case was whether *purchasers* of stock could recover under §10(b) for misrepresentations and omissions in prospectuses and registration statements made unlawful by §11 of the Securities Act of 1933, 15 U.S.C. §77k. The trial court held that they could not, reasoning that since Congress imposed restrictions on a §11 action, *e.g.*, a short statute of limitations and discretion in the court to require security, it could not have intended that recovery be had under §10(b) for the same conduct, free of the procedural restrictions. The Court of Appeals reversed, saying:

> "A suit under §11 of the 1933 Act requires no proof of fraud or deceit, and such a suit may be maintained only by one who comes within a narrow class of persons, *i.e.*, those who purchase securities that are the direct subject of the prospectus and registration statement (here the purchasers of preferred stock). But proof of fraud is required in suits under §10(b) of the 1934 Act and Rule X-10B-5 [citing "Cf. Norris & Hirschberg, Inc. *v.* S.E.C., 85 U. S. App. D.C. 268, 177 F. 2d 228, 230; Ward LaFrance Truck Corporation, 13 S.E.C. 372, 381 note"], which was validly promulgated by the S.E.C. pursuant to that section. Congress, reasonably, and without inconsistency, allowed suits of that sort which (1) are free of the restrictions applicable to a suit under §11 of the 1933 Act and (2) which are not confined to those persons who may properly sue under that section but which include all who are victims of the fraud. We think that when, to conduct actionable under §11 of the 1933 Act,

> there is added the ingredient of fraud, then that conduct becomes actionable under §10(b) of the 1934 Act and the Rule, at the suit of any defrauded person, whether or not he could maintain a suit under §11 of the 1933 Act." 188 F. 2d at 786-87.

It will be noted that the court did not say "scienter" was required, but that "fraud" was.[7] Contrary to Petitioners' unexplained assumption;[8] the terms are not identical.[9] That the *Fischman* court did not equate them is shown by considering the cases it cited supporting the proposition that proof of "fraud" is required in §10(b) actions. See BROMBERG, SECURITIES LAW: FRAUD §2.4(2) at page 35. In *Norris & Hirschberg, Inc.* v. *SEC*, 177 F. 2d 228 (D.C. Cir. 1949), the court affirmed an SEC finding that a corporation had violated Rule 10b-5, concluding that despite the fact that petitioner's conduct did not involve common law fraud, still it could "only be described as manipulative, deceptive and fraudulent," and that

> "To say, as petitioner does, that every element of common law fraud must be proven * * * is to say that Congress had no purpose in enacting regulatory statute in this field and that its legislation is meaningless." 177 F. 2d at 233.

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7. The facts made it unnecessary for the *Fischman* court to direct itself to the question whether the "fraud" to which it referred required "scienter," in the sense urged by Petitioners here. The plaintiffs in *Fischman* were prepared to prove the representations in question "were wilfully and knowingly misleading"—fraud under any test. 188 F. 2d at 785.

8. "In those circumstances, there would be no fraud—*i.e.*, no 'scienter' * * *" (Petition 11).

9. The District Court herein recognized this, stating that "The language used [in the Act and Rule 10b-5] is broader than the common terms of fraud or misrepresentation. The latter terms are used by lawyers and courts and will be used here" (A. 59).

In *Ward LaFrance Truck Corp.*, 13 S.E.C. 373 (1943), the Commission referred to Rule 10b-5 as an "antifraud" provision (13 S.E.C. at 381 n.), but showed it did not mean "fraud" in the common-law sense by including no findings or discussion as to "scienter" to support its conclusion that 10b-5 had been violated. It emphasized only that the insiders' nondisclosure "placed the stockholders at a distinct disadvantage" (13 S.E.C. at 379), and "*acted as* a deceit" upon them (13 S.E.C. at 380). [Emphasis added.]

That *Fischman* is not in "real and embarrassing conflict" with the Court of Appeals statement herein is shown by the fact that several district courts in the Second Circuit agree that "scienter" is not a prerequisite of §10(b) recovery. *Miller* v. *Steinbach*, 268 F. Supp. 255, 279 (S.D.N.Y. 1967); *SEC* v. *Texas Gulf Sulphur Co.*, 258 F. Supp. 262, 277-78 (S.D.N.Y. 1966); *Dack* v. *Shanman*, 227 F. Supp. 26, 29 (S.D.N.Y. 1964). *But see, Richland* v. *Crandall*, 262 F. Supp. 538, 553 n. 12 (S.D.N.Y. 1967); *Weber* v. *C.M.P. Corp.*, 242 F. Supp. 321 (S.D.N.Y. 1965); *Thiele* v. *Shields*, 131 F. Supp. 416, 419 (S.D.N.Y. 1955). If there is confusion among the district courts in the Second Circuit,[10] that is a matter of concern to the Court of Appeals for the Second Circuit, not this Court.

Except for the three Southern District of New York cases just cited, all courts agree that "scienter" is not required in §10(b) actions. *Stevens* v. *Vowell*, 343 F. 2d 374, 379-80 (10th Cir. 1965); *Kohler* v. *Kohler Co.*, 319

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10. *Fischman* apparently confuses even the courts in the "commercial and financial center" which deal "with a significant number of all actions brought under Rule 10b-5." (See Petition 12.)

The courts of appeals were established for the express purpose of relieving this Court of supervision over district court decisions. ROBERTSON & KIRKHAM, JURISDICTION OF THE SUPREME COURT OF THE UNITED STATES §325, at p. 637 (Wolfson & Kurland ed. 1951).

F. 2d 634, 637 (7th Cir. 1963), *affirming* 208 F. Supp. 808, 822 (E.D. Wis. 1962); *Royal Air Properties, Inc.* v. *Smith,* 312 F. 2d 210, 212 (9th Cir. 1962); *Ellis* v. *Carter,* 291 F. 2d 279, 273-74 (9th Cir. 1961); *Barles* v. *Bear, Stearns & Co.,* CCH FED. SEC. L. REP. ¶91,674 (N.D. Ill. 1966); *Pappas* v. *Moss,* 257 F. Supp. 345, 363 n. 5 (D.N.J. 1966); *Carliner* v. *Fair Lanes, Inc.,* 244 F. Supp. 25, 28-29 (D. Md. 1965); *Texas Continental Life Ins. Co.* v. *Bankers Bond Co.,* 187 F. Supp. 14, 22-24 (W.D. Ky. 1960), *reversed on other grounds,* 307 F. 2d 242 (6th Cir. 1962). Petitioners claim that the District Court for the District of Colorado, in *Parker* v. *Baltimore Paint & Chemical Corp.,* 244 F. Supp. 267 (D. Colo. 1965), and *Trussel* v. *United Underwriters, Ltd.,* 228 F. Supp. 757 (D. Colo. 1964), required scienter; it is plain, however, that it did not use the term "scienter" in the sense Petitioners do. The court specifically stated that "constructive fraud," *i.e.,* making a statement with reckless disregard as to whether it is true, is sufficient. 228 F. Supp. at 772.

Moreover, the reasoning of the cases holding scienter not to be required is so cogent and compelling that there is little reason to doubt that all the courts of appeals will adopt it when presented with the question. See *Ellis* v. *Carter, supra,* 291 F. 2d 270, 273-74 (9th Cir. 1961); *Texas Continental Life Ins. Co.* v. *Bankers Bond Co., supra,* 187 F. Supp. 14, 22-24 (W.D. Ky. 1960); see also BROMBERG, SECURITIES LAW: FRAUD §§2.4(2) at page 36, 2.6(1) at page 50, 8.4 at page 203 (1967); Fleischer, *"Federal Corporation Law": An Assessment,* 78 HARV. L. REV. 1146, 1178 n. 147 (1965); Comment, *Negligent Misrepresentations Under Rule 10b-5,* 32 U. CHI. L. REV. 824 (1965); Note, 63 MICH. L. REV. 1070 (1965). The provisions of §10(b) and Rule 10b-5 are certainly no more amenable to construction as

requiring scienter than those of the Investment Advisors Act, 15 U.S.C. §80b-6; this Court has held that it would defeat Congress' manifest purpose to hold that the Advisors Act required proof of intent to injure. *SEC* v. *Capital Gains Research Bureau*, 375 U. S. 180 (1963).

(4) *Satisfactory Development.* On issues as complex as that raised by the "scienter" question, case-by-case development by lower courts is crucial in determining when a matter is "ripe" for review. It appears that the lower courts are in the process of satisfactorily developing the correct rule in this area on a case-by-case basis. Because of the multiplicity of fact situations to which §10(b) can be applied and the wide range of possible proof requirements which might be formulated (*e.g.*, intent, recklessness, gross negligence, simple negligence, failure to ascertain, complete innocence, and presumptions concerning the same), this Court should have the aid of the fully-developed, articulated and studied thinking of as many courts of appeals as possible before allowing the matter to mature into a determination by this Court. This seems peculiarly appropriate in an area in which it would be "desirable to have different aspects of" the issue "further illumined by the lower courts." *Maryland* v. *Baltimore Radio Show, Inc.*, 338 U. S. 912, 918 (1950) (opinion of Frankfurter, J. respecting denial of certiorari). A much more appropriate case for review would be one presented after such development has occurred and one in which the issue is squarely presented procedurally and factually.[11]

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11. Petitioners also attempt to raise the question whether the present case must be deemed time-barred, assuming it involved only innocent misrepresentations or omissions (Petition 15). It is much too late for Petitioners to raise this point, not having done so before either the District Court of the Court of Appeals. *Vaughan* v. *Atkinson*, 369 U. S. 527, 531 n.3 (1962); *Quicksall* v. *Michigan*, *supra*, 339 U. S. 660, 666 n.3 (1950); *McCullough* v. *Kammerer Corp.*, 323 U. S. 327, 328-29 (1945).

D. There is no reason to grant review of the holding that corporate defendant could be liable for violations of §10(b).

Petitioners urge review of the judgment against the corporate defendant on the simple ground that it cannot be charged with

> "misrepresentations or omission made by an officer or director in connection with the selling or buying of the stock * * *" (Petition 21).

On this unimportant and routine issue, Petitioners do not even *assert* a conflict. The only case they cite is *Kohler* v. *Jacobs,* 138 F. 2d 440, 443 (5th Cir. 1943), holding that a corporation *could* be deemed liable where stock is procured for it through its officer's fraud—an unlikely reason for review. Moreover, regardless of the rule Petitioners invoke with respect to situations where an officer or director buys only for his own personal account, *Kohler* v. *Jacobs,* 138 F. 2d 440, 443 (5th Cir. 1943) (dicta); 10 FLETCHER, CYCLOPEDIA CORPORATIONS §4886 at 506 (Rev. ed. 1961), the rule is certainly different where, as here, an insider buys for the corporation, the stock is in fact delivered to the corporation, and the corporation makes payments therefor. It is clear that the §10(b) principles of liability "apply not only to majority stockholders of corporations and corporate insiders, but equally to corporations themselves when acting through their officers, directors, or agents."[12] *Kohler* v. *Kohler Co.,* 319 F. 2d 634, 638 (7th Cir. 1963); see *Kohler*

12. An alternative ground for holding the corporation liable is the principle that a "controlling person" may be held liable for failure to prevent misconduct by those within such person's control. See, *e.g., Brennan* v. *Midwestern United Life Ins. Co.,* 259 F. Supp. 673, 680-82 (N.D. Ind. 1966) (corporation); *Lorenz* v. *Watson,* 285 F. Supp. 724, 733 (E.D. Pa. 1966) (individual).

v. *Jacobs, supra,* 138 F. 2d 440, 442-43 (5th Cir. 1943). It is also plain that the fact that the shares were retired rather than resold is immaterial, in that a party may be held responsible for tortious wrongdoing although he realized no benefit from it. See *James-Dickinson Farm Mortgage Co.* v. *Harry,* 273 U. S. 119, 123 (1926), and cases cited; *Fischer* v. *Kletz,* 266 F. Supp. 180, 187-88, 193 (S.D.N.Y. 1967) (§10(b) case). There is nothing in Petitioners' suggestion (page 21) that "since 1962, 150,000 additional shares of LII have been issued to the public,"[13] which changes the application of these principles. The Court of Appeals was clearly correct in saying:

> "The fact that bona fide public stockholders might indirectly be prejudiced by the corporation's payment of indebtedness incurred by a predecessor corporation is not persuasive. Stockholders are presumed to invest with knowledge of proper corporate liabilities. If any harm exists by reason of the corporation's legal liabilities wrongfully caused by its officers or directors, such damage can be corrected through proper proceedings" (A. 50-51).

Petitioners raise no point upon which any conflict in decisions exists, and otherwise show no reason justifying this Court's consideration.

E. No conflict exists because the Court of Appeals did *not* hold that a "grossly negligent plaintiff" may recover under Rule 10b-5.

The conflict Petitioners suggest and their argument at pages 21-22 is premised entirely on the assumption that "Respondent Vertelney was found by the Court of Appeals to have been, if anything, 'grossly negligent'" (A. 23).

13. There is no indication who comprises this "public."

This assumption is false, and is based on nothing but a gross mischaracterization of what the Court of Appeals said. The Court's statement must be read in the context of its entire discussion. See A. 22-25. Such a reading clearly shows that the Court of Appeals held that given the circumstances *"in this particular case"* (A. 23), Vertelney was properly found to have acted reasonably. The Court spoke of "gross negligence" only to provide its assessment of the hypothetical situation which would have existed had Phil Myzel's statements or nondisclosures concerned only LPE's financial condition and business affairs. However, the Court clearly distinguished this hypothetical situation from that presented to the jury. The Court emphasized that the evidence showed that other important statements and nondisclosures justified the jury's finding of Vertelney's conduct to be reasonable.[14]

Thus, there is utterly no conflict with *List* v. *Fashion Park, Inc.*, 340 F. 2d 457 (2d Cir.), *cert. denied*, 382 U. S. 811 (1965). That case held that a plaintiff may not recover if it appears as a matter of law he would have acted no differently had he known the falsity of the representations and the existence of the facts omitted.[15] With this propo-

14. The Court emphasized that the evidence justified findings: (1) that Phil Myzel's affirmative statement that Benn Myzel "doesn't think they are going anywhere" and was "going to get out" were very important to Vertelney, since Benn Myzel was Vertelney's trusted friend and advisor and, as Vertelney knew, was intimately involved with the corporation; (2) that Phil's failure to disclose the true purchasers was very significant; (3) that the "labyrinthine transfers" used to conceal the transaction caused the true identity of the purchaser to be "effectively hidden from even a most alert director or insidr"; and (4) that "under the particular setting involved that there was created a diminished necessity" to make inquiry such as would have been required had Phil Myzel's representations and omissions related strictly and only to the affairs of LPE. See A.22-25.

15. Respondents would also agree with the dicta in *List* which suggest that recovery may not be had unless the individual plaintiff actually relies upon statements or omissions upon which a reasonable man, in the same circumstances, could rely. *List* v. *Fashion Park, Inc., supra* at 462. As noted above, the jury was held to have properly found Vertelney acted reasonably.

sition Respondents agree. It is clear that the jury herein properly found Vertelney would not have sold his stock had he known the falsity of the representations and the existence of the matters omitted. Petitioners' citation of *Hafner* v. *Forest Laboratories, Inc.*, 345 F. 2d 167 (2d Cir. 1965), for the proposition that a plaintiff whose claim is based on facts which were equally available to both buyer and seller may not recover, is completely inapposite; Phil Myzel made affirmative representations as to Benn Myzel's actions and views, and failed to disclose the true purchasers, which facts certainly were not as available to Vertelney as they were to Phil Myzel.

F. The holding on measure of damages does not conflict with any court of appeals decision.

Petitioners assert (at 16) that "in permitting recovery by the sellers of an amount greater than the difference between the value of the stock at the time of sale and the amount of consideration received," the courts below reached a result which "conflicts" with *Estate Counselling Service* v. *Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 303 F. 2d 527 (10th Cir. 1962). This inexcusably ignores the fact that *Estate Counselling Service* applied the "out-of-pocket" rule to a §10(b) case brought by a *purchaser* of stock. That holding in no way governs §10(b) cases bought by *sellers* of stock, and it is clear that a different rule should apply in such cases. Where a defrauded *purchaser* of stock is the plaintiff, subsequent history of the stock is not germane to his damages. The purchaser in such a case loses nothing other than the definite amount of money which he paid when purchasing the stock. Assuming the defrauded *seller* of stock would have retained it had he known the true state of affairs, he loses

whatever appreciation in value of the stock occurs between the time of sale and time of discovery of the fraud.[16] Any measure of damages must take into account this difference. The differences between purchasers and sellers are carefully explained in *Janigan* v. *Taylor*, 344 F. 2d 781 (1st Cir.), *cert. denied*, 382 U. S. 879 (1965):

> "With respect to damages we draw a distinction between cases where, by fraud, one is caused to buy something that one would not have bought or would not have bought at that price, and where, by fraud one is induced to convey property to the fraudulent party. In the former case the damages are to be reckoned solely by 'the difference between the real value of the property at the date of its sale to the plaintiffs and the price paid for it, with interest from that date, and, in addition, such outlays as were legitimately attributable to defendant's conduct, but not damages covering "the expected fruits of an unrealized speculation."' Sigafus *v.* Porter, 1900, 179 U. S. 116 * * * See Estate Counselling Service, Inc. *v.* Merrill Lynch, Pierce, Fenner & Smith, Inc. * * * On the other hand, if the property is not bought, but sold to the fraudulent party, future accretions not foreseeable at the time of the transfer even on the true facts, and hence speculative, are subject to another factor, viz., that they accrued to the fraudulent party. It is more appropriate to give the defrauded party the benefit even of windfalls than to let the fraudulent party keep them." 344 F. 2d at 786.[17]

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16. In fact, the jury was further limited in the instruction to a "reasonable period" subsequent to the sale (R. 893).

17. Petitioners claim (Petition 17) that "the *Janigan* rule is one which is specifically applicable only to 'conscious wrongdoers,'" is inaccurate. *Janigan* involved such a wrongdoer, but the court nowhere suggested its measure of damages was limited to such facts (even if it had, it would have been mere dicta and thus could not

These crucial differences are not considered in *Kohler* v. *Kohler Co.*, 208 F. Supp. 808 (E.D. Wis. 1963), (which was decided prior to *Janigan* v. *Taylor, supra*) cited by Petitioners at pages 17. That court held that under §10(b) the plaintiff there had failed to prove any wrongful conduct. The court's gratuitious statement that plaintiff "suffered no damage" because the stock was worth no more than what was paid, was an alternative ground totally ignored by the Court of Appeals for the Seventh Circuit on appeal. Accordingly, since neither *Estate Counselling Service* nor *Kohler* are *contra* to the present case there is no conflict among the courts of appeals.

The only courts of Appeals which have really faced the issues in this case are the First Circuit in *Janigan* v. *Taylor, supra,* and the Eighth Circuit in the present case. Both reached the same result. But an issue of this nature, involving the marked distinctions between a sale of tangible property and a sale of fungible intangibles with volatile values, should receive treatment at the trial court level before the measure of damages in all its ramifications can be considered "ripe" for review by this Court. The measure of damage should be allowed to "operate" in instruction form or by application by deciding courts. Moreover,

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have created a conflict). There is no reason to doubt that the *Janigan* court, when employing the terms "fraud," "fraudulent," and "defrauded," was using them as words of art, rather than in their common-law sense. See discussions at pages 21n. 4, 25-26. Further, it is much too late for Petitioners to raise this point. They did not request the trial court to instruct the jury that a different measure of damages would apply if the "wrongdoing" was "conscious." Nor did they object to the absence of such an instruction. Moreover, Petitioners' statement that there may have been no "scienter" in this case is erroneous. As explained above, pages 22-23 *supra,* it appears as a matter of law in this case that the misrepresentations or omissions were made with knowledge of the false or misleading nature of the impression they produced.

the nuances of the market for securities must be given full play in order that all the issues involved in applying a measure of damages can be distilled to something more than abstract application in a case involving the issue in a condition of first impression. It would be helpful if this type of prior consideration and amplification by the lower courts occurred before this Court reviewed the matter.

Moreover, the result reached by the courts below is the correct one. Petitioners state:

> "In fashioning an implied right of action under the general standards of Rule 10b-5, the lower courts have created, and are creating, a body of Federal corporate common law, much like the development of Federal law before *Erie R. R.* v. *Tompkins,* 304 U. S. 64 (1938). The measure of damages historically adopted in Federal cases involving common law actions for fraud and deceit has been the 'out-of-pocket' rule." (Petition 16.)

This is a nonsequitur. That federal courts are creating a body of law under §10(b) certainly does not mean that they must rigidly adhere to standards formulated when creating another body of law, *i.e.* federal common law. The intention of Congress under the Act was that the remedies in civil actions "should be in addition to any and all other rights and remedies that may exist at law or in equity." Securities Exchange Act of 1934, §28(a), 15 U.S.C. §78bb(a). In *Chicago Board of Trade* v. *Johnson,* 264 U. S. 1 (1924), this court found that federal policy evidenced by federal statutes overrides and dominates general common law principles.

> "[W]hen the language of Congress indicates a policy requiring a broader construction of the statute

> than the state decisions would give it, Federal Courts cannot be concluded by them." 264 U. S. at 10.

Thus, in *SEC* v. *Capital Gains Research Bureau,* 375 U. S. 180 (1963), this Court stated:

> "There has also been a growing recognition by common law courts that the doctrines of fraud and deceit which developed around transactions involving land and other tangible items of wealth are ill-suited to the sale of such intangibles as advice and securities, and, that, accordingly, the doctrines must be adapted to the merchandise in issue." 375 U. S. at 194.

Clearly the trial court and the Court of Appeals in this case adjusted their thinking and the application of the measure of damages to "the merchandise in issue." The instruction, while it might conflict with the venerable but outdated principles of the common law "out-of-pocket" rule under federal law, see *Smith* v. *Bolles,* 132 U. S. 125 (1889), allowed the jury to assess damages properly approximating what was actually lost by the Respondents.[18]

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18. Petitioners' contention that allowing damages greater than those permitted under an out-of-pocket rule conflicts with §28(a) of the Securities Exchange Act, 15 U.S.C. §78bb(a) limiting recovery to "actual damages on account of the act complained of," begs the question. An appropriate measure of damages assumes that "actual damages" are being assessed. The Court of Appeals was clearly correct in stating that:

> "[W]e feel the only effect of this provision is to prohibit punitive damages, which otherwise might be available in some states in civil actions under the Securities Exchange Act of 1934." (A. 48).

Conclusion

No conflict prevails among the courts of appeal on any of the "questions presented" by Petitioners. And there appear no novel and important aspects which could lead to the discretionary exercise of the power to review.

For the foregoing reasons, the Petition for Writ of Certiorari should be denied.

Respectfully submitted,

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IN THE

Supreme Court of the United States

October Term, 1967

No. 996

BENJAMIN (BENN) MYZEL, *et al.*,
Petitioners,

v.

HARRY FIELDS,
Respondent.

BENJAMIN (BENN) MYZEL, *et al.*,
Petitioners,

v.

SAMUEL H. KING,
Respondent.

BENJAMIN (BENN) MYZEL, *et al.*,
Petitioners,

v.

RITA VERTELNEY, Special Administratrix, etc.,
Respondent.

BENJAMIN (BENN) MYZEL, *et al.*,
Petitioners.

v.

GORDON M. COHEN,
Respondent.

REPLY BRIEF IN SUPPORT OF PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

Petitioners submit this Reply Brief in response to the Brief in Opposition of Respondents Fields, King, Vertelney and Cohen.

Respondents' brief in opposition attempts to obscure genuine issues of law by artificially creating factual and

procedural controversies more properly relevant to a brief on the merits. This is particularly illustrated by Respondents' attempt to bury the issue of scienter, which Petitioners believe is vitally important not only in this case but also in almost every action brought under Rule 10b-5.

The district court's instructions clearly did not require a finding of scienter (R. 786-87), thereby permitting recovery based solely on innocent or negligent misstatements or omissions. Petitioners preserved this issue by objecting to the district court's failure to charge the jury on the scienter issue (R. 800, 810, 832, 834).

Respondents contend that Petitioners did not properly present the issue of scienter before the Court of Appeals. This is amply refuted by the fact that the Court of Appeals specifically discussed and decided this issue (A 15, A 19). The Court of Appeals correctly determined that resolution of this issue was required in order to rule upon Petitioners' contentions. Respondents' reliance on *California* v. *Taylor*, 353 U.S. 553, 556 n. 2 (1957), is misplaced. This Court in *Taylor* specifically noted that the Court of Appeals had determined that the issue in question had been waived. In the present action, there was no such finding by the Court of Appeals; instead, the Court of Appeals identified the issue, considered it, and resolved it against Petitioners.

Finally, Respondents also state that "no real and embarrassing conflict exists between courts of appeals." This contention disregards the basic inconsistency between the decision below and *Ellis* v. *Carter*, 291 F. 2d 270 (9th Cir. 1961), on the one hand, and the holding in *Fischman* v. *Raytheon Mfg. Co.*, 188 F. 2d 783 (2d Cir. 1951) that proof of fraud is required in an action under Rule 10b-5, on the

other. No matter how Respondents choose to interpret the holding in *Fischman,* it cannot be reconciled with the standard of absolute liability set forth in the district court's instructions and adopted by the Eighth Circuit. The lower courts have themselves noted the conflict, as pointed out in the Petition, and discussed by Judge Wyatt in *Weber* v. *C.M.P. Corp.,* 242 F. Supp. 321, 324-25 (S.D.N.Y. 1965).

Respondents are attempting to ignore the plain fact that the Court of Appeals has decided an important question of Federal law which has not been settled by this Court. The need for clarification of Rule 10b-5 in both the business and legal community has been reemphasized once again in Barron's (February 19, 1968, p. 5), an important business publication. The confusion among courts of appeals and district courts exists and will not be resolved unless and until this Court decides this issue.

Petitioners need not reiterate the other issues set forth in their Petition. Despite Respondents' attempts to obscure these issues, they are real and vitally important, for both this case and future actions arising under Rule 10b-5. Petitioners therefore respectfully urge this Court to grant the petition for a writ of certiorari.

Respectfully submitted,

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